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No. 07-____

In The
Supreme Court of the United States

CENTERIOR ENERGY CORPORATION ET AL.,
Petitioners,

v.

JEROME R. MIKULSKI ET AL.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

MITCHELL G. BLAIR
TRACY SCOTT JOHNSON
COLLEEN MORAN O'NEIL
CALFEE, HALTER & GRISWOLD LLP
1400 McDonald Investment Center
800 Superior Ave.
Cleveland, OH 44114
(216) 622-8200

THOMAS C. GOLDSTEIN
(Counsel of Record)
PATRICIA A. MILLETT
MONICA P. SEKHON
AKIN GUMP STRAUSS HAUER & FELD, LLP
1333 New Hampshire Ave., NW
Washington, DC 20036
(202) 887-4000

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

Federal law requires petitioners to report to the Internal Revenue Service and to shareholders the amount of dividends they distribute. *See* 26 U.S.C. § 6042(a)(1), (c). Petitioners' shareholders (respondents here) assert that, in making those reports, petitioners incorrectly interpreted another federal tax provision that affects whether distributions to shareholders qualify as dividends for federal tax purposes. 26 U.S.C. § 312(n)(1). Respondents allege that petitioners' misstatements in the federally required reports defrauded them by causing them to overpay their income taxes. Respondents did not file a tax refund action, but instead sued petitioners in state court seeking damages measured by the amount of allegedly overpaid taxes. A divided en banc Sixth Circuit held that federal courts lacked jurisdiction over the suit.

The question presented is:

Whether a lawsuit that turns critically on the proper construction of the Internal Revenue Code and that seeks to recover overpaid income taxes on the basis of reports required by federal tax law "aris[es] under" federal law, 28 U.S.C. §§ 1331, 1340, or is completely preempted.

PARTIES TO THE PROCEEDING

Petitioners are Centerior Energy Corporation, FirstEnergy Corporation, Cleveland Electric Illuminating Company, and The Toledo Edison Company.

Respondents are Jerome R. Mikulski and Elzetta C. Mikulski, on behalf of themselves and all others similarly situated.

RULE 29.6 STATEMENT

Petitioner FirstEnergy Corporation has no parent company, and no public company owns ten percent or more of its stock. Petitioners Centerior Energy Corporation, Cleveland Electric Illuminating Company, and The Toledo Edison Company are wholly-owned subsidiaries of FirstEnergy Corporation.

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PETITION FOR A WRIT OF CERTIORARI

Centerior Energy Corporation, FirstEnergy Corporation, Cleveland Electric Illuminating Company, and The Toledo Edison Company respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The en banc opinion of the court of appeals (App., *infra*, 1a-48a) is reported at 501 F.3d 555. The opinion of the panel of the court of appeals (App., *infra*, 49a-73a) is reported at 435 F.3d 666. The opinion of the district court (App., *infra*, 74a-81a) is not reported.

JURISDICTION

The court of appeals entered its judgment on August 21, 2007. Justice Stevens subsequently extended the time within which to file a petition to and including January 18, 2008. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT STATUTORY AND REGULATORY PROVISIONS

The relevant statutory and regulatory provisions are reproduced at App., *infra*, 98a-102a.

STATEMENT OF THE CASE

Respondent shareholders allege that petitioners misconstrued federal tax law and, as a result, made incorrect statements in federally required reports, which allegedly caused respondents to overpay their income taxes. The shareholders sued petitioners in state court on state law misrepresentation and breach of contract theories. Petitioners removed the

action to federal court, and the district court held that federal jurisdiction was proper because the case arose under federal law and, indeed, was completely preempted by the Internal Revenue Code. A sharply divided en banc court of appeals reversed.

1. a. Under 28 U.S.C. § 1331, "[t]he district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." 28 U.S.C. § 1340 further provides that "[t]he district courts shall have original jurisdiction of any civil action arising under any Act of Congress providing for internal revenue, or revenue from imports or tonnage except matters within the jurisdiction of the Court of International Trade."

b. Federal tax law governs the reporting of a corporation's distributions to its shareholders. The corporation must disclose to the Internal Revenue Service and the shareholders, *inter alia*, "the aggregate amount of the dividends, the name, address, and taxpayer identifying number of the person to whom paid, [and] the amount of tax deducted and withheld * * * from the dividends, if any." 26 C.F.R. § 1.6042-2(a)(1)(i). *See* 26 U.S.C. § 6042(a)(1). The report must be made on federal Form 1099-DIV, *available at* http://www.irs.gov/pub/irs-pdf/f1099div.pdf, or (in the case of information provided to shareholders) "an acceptable substitute," 26 C.F.R. § 1.6042-4(b).[1] Failure

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[1] A corporation is generally required to report earnings and profits to the IRS and submit information concerning the calculations used on Form 5452 whenever "it determines that its distributions are partly or wholly not taxable as dividends." Rev. Proc. 75-17, 1975-1 C.B. 677, § 8; *see* Form 5452, *available at* http://www.irs.gov/pub/irs-pdf/f5452.pdf.

to comply may result in federal civil or criminal penalties. 26 U.S.C. §§ 6721(a), (e), 6722, 7203; 26 C.F.R. §§ 301.6721-1(a), (f), 301.6722-1(a), (c).[2]

In reporting distributions, the corporation must distinguish "dividends" from "returns of capital." *See* Form 1099-DIV. "Dividends," which are distributions made from the corporation's earnings and profits, are taxed as ordinary income. 26 U.S.C. §§ 301(c)(1), 316(a). "Returns of capital," which are distributions that exceed earnings and profits, are taxed (to the extent they exceed the shareholder's adjusted basis in the stock) as capital gains. *Id.* § 301(c)(2)-(3). Because, under certain circumstances, taxes are lower on capital gains than dividends, some shareholders benefit financially if distributions are characterized as capital gains.

With respect to calculating a corporation's earnings and profits, Section 312 of the Internal Revenue Code requires certain adjustments. Of particular relevance here, Section 312(n)(1) requires certain construction expenses "paid or incurred in taxable years beginning after September 30, 1984" to be included in calculating earnings and profits. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 61(e), 98 Stat. 494 (1984).[3]

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[2] In addition, the Secretary of the Treasury may direct a corporation to deduct and withhold a specified amount of income tax if the shareholder underreports income or other reporting problems arise. 26 U.S.C. § 3406(c)(1)-(2); *see* App., *infra*, 88a.

[3] Section 312(n)(1) provides that, "[f]or purposes of computing * * * earnings and profits," "in the case of any amount paid or incurred for construction period carrying charges," "the basis of the property with respect to which such charges are allocable shall be increased by that amount." 26 U.S.C. § 312(n)(1)(A).

Finally, federal tax law provides that taxpayers seeking relief for the overpayment of federal taxes, including shareholders that pay their taxes based on income reported on Form 1099-DIV, must first seek relief administratively from the IRS and then, if necessary, in federal court. "No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected * * * or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof." 26 U.S.C. § 7422(a). A taxpayer dissatisfied with the outcome of the administrative proceeding may file a tax refund action, but such "[a] suit or proceeding * * * may be maintained only against the United States," and thus must be brought in federal court. *Id.* § 7422(f)(1).

2. Between 1985 and 1997, petitioners made distributions to their shareholders, which they reported both to the shareholders and to the IRS on Form 1099-DIV as required by federal law. In determining what portions of the distributions constituted taxable dividends, petitioners interpreted 26 U.S.C. § 312(n)(1) to encompass expenses relating to those

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"[C]onstruction period carrying charges" include "interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry property" "to the extent such interest, taxes, or charges are attributable to the construction period for such property and would be allowable as a deduction in determining taxable income * * * for the taxable year in which paid or incurred." *Id.* § 312(n)(1)(B).

construction projects that were ongoing as of January 1, 1985, thereby increasing petitioners' earnings and profits and the amount of shareholder distributions constituting taxable dividends. App., *infra*, 98a.

Respondents are a putative class of FirstEnergy shareholders. They contend that petitioners misconstrued 26 U.S.C. § 312(n)(1), which they argue includes in earnings and profits only construction expenses incurred after January 1, 1985.[4] The shareholders contend that, as a result of that mistaken construction of federal tax law, they overpaid their taxes in reliance on petitioners' allegedly erroneous 1099-DIV forms.

The shareholders never sought a refund of overpaid taxes from the IRS. *See* App., *infra*, 94a. Instead, in 2002, they filed a series of class action suits against petitioners in Ohio state court asserting state law claims of breach of contract and fraudulent misrepresentation. The shareholders contend that petitioners "breached [their] written contract with the Plaintiff class * * * by misreporting to class members * * * the portion of the 1986 distributions which constituted taxable dividends and the portion which constituted a return of capital." *Id.* at 13a. The complaint seeks damages that are measured by the overpayment of taxes, plus punitive damages and attorneys' fees. Amended Complaint at 10-11.

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[4] Congress recognized uncertainty surrounding the application of Section 312(n)(1) and expected the IRS to issue more detailed instructions, *see* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 at 177 (Comm. Print 1984), but the IRS did not issue the expected regulations.

Petitioners timely removed the suits to federal district court, which held that removal was proper, explaining that the shareholders' "Complaint, while attempting to create a state law cause of action, clearly requires the construction and interpretation of the Internal Revenue Code, relevant Regulations, and Federal law for resolution of Plaintiffs' claims," App., *infra*, 80a, and that the shareholders' "claims for relief turn on whether [petitioners] violated Section 312(n)(1) of the Internal Revenue Code," *id.* at 70a. The court also adopted a magistrate judge's decision, which explained that "[t]here is no question that plaintiffs could have raised this issue with the IRS, could have filed for a refund and could have pursued administrative remedies," *id.* at 94a, and "[t]he efforts to pursue a tax refund from defendants appear[] to this court to be simply an end run around [the tax refund statute] to avoid the statute of limitations defense," *id.* at 95a. The district court further held that respondents' claims are completely preempted by the Internal Revenue Code. *Id.* at 80a.

3. A divided panel of the Sixth Circuit reversed, holding that respondents could proceed with their claims in state court. App., *infra*, 49a-73a. The full court granted rehearing en banc and, by a vote of 8 to 5, held that the claims do not arise under federal law and thus were improperly removed. *Id.* at 1a-48a.

The en banc majority first rejected petitioners' argument that respondents' claims are completely preempted by the federal tax refund scheme. App., *infra*, 20a. The court viewed the relevant inquiry as whether Congress intended a tax refund action to be the "exclusive remedy for a company's misreporting

of dividends," and concluded that it did not. *Id.* at 18a. The majority distinguished the contrary holdings of other circuits that the Internal Revenue Code preempts claims against private parties that are required to aid the IRS in its tax collection efforts on the ground that, in those cases, the private parties directly collected or withheld the taxes. *Id.* at 18a-19a.

The majority further held that the shareholders' claims do not "arise under" federal law, within the meaning of 28 U.S.C. § 1331. The majority acknowledged that "plaintiffs may not avoid removal jurisdiction by artfully casting their essentially federal law claims as state-law claims," App., *infra*, 9a, and that plaintiffs "had certainly staked their claim on th[e] federal issue" of 26 U.S.C. § 312(n)(1)'s proper reach, *id.* at 30a. The court also acknowledged this Court's decision in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308, 310 (2005), which held that there is federal question jurisdiction over a case that turned on the parties' conflicting interpretations of a federal tax provision because "the national interest in providing a federal forum for federal tax litigation is sufficiently substantial to support the exercise of federal question jurisdiction over the disputed issue." App., *infra*, 23a-26a.

The Sixth Circuit majority nevertheless concluded that, while the question of federal tax law presented in this case "may very well be" "significant," it was not "substantial" under a multi-factor analysis. App., *infra*, 37a. The majority looked to the particular tax provision at issue, viewing it as insufficiently substantial because it pertains to income "accounting."

Id. at 33a. The court explained that, "[b]ased on our subjective view of this issue, we find it more likely than not that this particular question is not particularly important to the federal government." *Ibid.* The court also noted that no federal agency was a party to the suit. *Id.* at 31a-32a. The majority further reasoned that the issue was not substantial because the state court's construction of federal tax law would not bind the federal government, which would remain free to enforce a conflicting interpretation of Section 312(n)(1). *Id.* at 32a. The court also noted that the federal tax provision at issue "does not control the collection of the plaintiffs' personal income taxes *directly*." *Id.* at 37a. Finally, the majority expressed concern that recognizing federal jurisdiction "would impermissibly disrupt the congressionally approved balance of federal and state judicial responsibilities," *id.* at 38a, by "encumbering the federal courts with these tax-code-related cases," *id.* at 39a.

Five judges dissented. App., *infra*, 41a. In their view, there is a "*substantial* federal interest in obtaining a federal court decision regarding the effective date of a provision of the federal Internal Revenue Code that will enhance the ability of a federal agency to collect the monies necessary to carry on the workings of the federal government." *Ibid.* The dissenting judges concluded that this Court's decision in *Grable* established that federal jurisdiction over the shareholders' suit is proper in light of "the national interest in providing a federal forum for federal tax litigation." *Id.* at 43a (emphasis omitted). The dissent reasoned that "the pure issue of law in this case" not only turns on the proper construction of the Internal

Revenue Code, but also "affects directly how much tax security-holders must pay." *Id.* at 45a (internal quotation marks and citations omitted). The dissent further noted that the shareholders themselves conceded "that an analysis of the tax code is 'critical' to the case and that a violation of the Code is not only the measure of damages but also the 'underlying rationale for the fraud.'" *Id.* at 47a. Finally, the dissent disagreed with the majority's estimation of the effects of recognizing jurisdiction on the federal caseload, explaining that "the refund procedures in the Internal Revenue Code, in conjunction with state statute of limitations, would act as a reasonable limit on the number of cases that were actually heard in federal court." *Id.* at 48a (internal quotation marks and citations omitted).

This petition followed.

REASONS FOR GRANTING THE WRIT

This Court's review of the sharply divided en banc decision of the Sixth Circuit is necessary to resolve conflicts between the ruling below and the decisions of this Court and other courts of appeals. Respondent shareholders' backdoor tax refund claim strikes at the heart of the mandatory reporting system that is critical to the federal government's collection of taxes, based on a claim that (i) rests critically on the proper construction of federal tax law and a corporation's federal reporting obligations, (ii) seeks compensatory damages measured exclusively by calculating the shareholders' proper tax payments, and (iii) circumvents the established federal remedial scheme for having a federal agency and federal courts determine and refund alleged overpayments of taxes. This

Court's decision in *Grable* establishes that federal "arising under" jurisdiction is proper in such tax cases. Other courts of appeals have hewed to this Court's precedent and would have retained federal jurisdiction – and, indeed, found the claim to be completely preempted – had the complaint been filed within their jurisdictions. The court of appeals' decision, moreover, creates a substantial risk that private parties charged with reporting income to the Internal Revenue Service will be forced to labor, at the pain of paying substantial tort damages (including punitive damages), under competing constructions of their federal tax law obligations adopted by state courts in tort actions and the Internal Revenue Service in federal proceedings. That would frustrate Congress's determination that questions of federal tax law arising from tax refund claims be resolved in a federal forum, and 28 U.S.C. § 1331's provision for federal "arising under" jurisdiction should be read in light of that "national interest in providing a federal forum for federal tax litigation." *Grable*, 545 U.S. at 310.

I. The Divided En Banc Court of Appeals' Decision Conflicts With This Court's Precedent.

In *Grable*, *supra*, this Court unanimously held that the federal courts have "arising under" jurisdiction over a state law claim that turns critically on a disputed issue of federal tax law. The plaintiff in that case brought suit in state court to quiet title to property against an individual who had bought the property after it was seized by the IRS to pay the plaintiff's tax debt. The plaintiff rested its claim to title on the assertion that the IRS had failed to provide proper notice of the seizure as required by federal

law. *Id.* at 310-11. Notably, the shareholders in this case filed a brief as *amicus curiae* in *Grable*, underscoring the direct parallels between the two cases and urging this Court to find federal jurisdiction lacking. *See* Brief of *Amici Curiae* Jerome R. Mikulski *Et Ux.* in Support of Petitioner at 1-3, *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308 (2005) (No. 04-603).

This Court unanimously rejected that argument. The Court recognized at the outset the well-settled proposition that "arising under" jurisdiction may apply to "state-law claims that implicate significant federal issues," a doctrine that "captures the commonsense notion that a federal court ought to be able to hear claims recognized under state law that nonetheless turn on substantial questions of federal law, and thus justify resort to the experience, solicitude, and hope of uniformity that a federal forum offers on federal issues." *Grable*, 545 U.S. at 312.

Applying that principle, the Court held that "the national interest in providing a federal forum for federal tax litigation is sufficiently substantial to support the exercise of federal question jurisdiction over the disputed issue on removal, which would not distort any division of labor between the state and federal courts, provided or assumed by Congress." *Id.* at 310. In upholding federal jurisdiction, the Court relied on the fact that the plaintiff had "premised" its claim on the adequacy of notice "as defined by federal law." *Id.* at 314-15. The "meaning of the federal statute [was] thus an essential element of" the state law claim. *Id.* at 315. That question, moreover, "is an important issue of federal law that sensibly belongs in a

federal court," given the government's "strong interest in the 'prompt and certain collection of delinquent taxes.'" *Ibid.* (quoting *United States v. Rodgers*, 461 U.S. 677, 709 (1983)). "Finally, because it will be the rare state title case that raises a contested matter of federal law, federal jurisdiction to resolve genuine disagreement over federal tax title provisions will portend only a microscopic effect on the federal-state division of labor." *Ibid.* Accordingly, in determining whether federal question jurisdiction was proper, this Court focused on the substantiality of the federal question presented and on whether resolution of the federal question would benefit from the "advantages thought to be inherent in a federal forum." *Id.* at 313 (citing *Chicago v. Int'l College of Surgeons*, 522 U.S. 156, 164 (1997); *Merrell Dow Pharms. Inc. v. Thompson*, 478 U.S. 804, 814 n.12 (1986); *Franchise Tax Bd. of Cal. v. Constr. Laborers Vacation Trust for S. Cal.*, 463 U.S. 1, 28 (1983)).

The court of appeals' decision in this case cannot be reconciled with *Grable*. As respondents themselves effectively acknowledged by filing a brief in *Grable*, the two cases cannot fairly be distinguished. The decisive and contested issue in both cases is the proper construction of a federal statute governing the collection of federal taxes, and that construction of federal law will control the outcome of the case. The federal questions in the case thus are both substantial and determinative, and there is *at least* as strong a federal interest in properly determining the effective date of tax provisions governing the amount of taxes owed (as in this case) – which can have a significant impact on revenue collection – as in determining how

notices of seizures of property are properly delivered (the subject of *Grable*). The need in federal tax law for the "uniformity that a federal forum offers," *Grable*, 545 U.S. at 312, applies as much, if not more, to tax provisions governing the calculation of income and the reporting obligations of corporations and individuals as it does to the notice rule in *Grable*.

Federal jurisdiction, moreover, fully comports with the "congressional judgment about the sound division of labor between state and federal courts," *id.* at 313, because Congress itself commanded that suits seeking to recoup overpaid federal taxes must be litigated in a federal forum, 26 U.S.C. § 7422. Limiting tax refunds to a federal forum promotes uniformity in decisions and efficiency in decisionmaking by ensuring that such issues "come before judges used to federal tax matters," *Grable*, 545 U.S. at 315. Indeed, unlike the Sixth Circuit majority here, this Court has long recognized that "[t]he revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application," *United States v. Irvine*, 511 U.S. 224, 238 (1994) (quoting *United States v. Pelzer*, 312 U.S. 399, 402-403 (1941)), and that congressional purpose should equally inform construction of 28 U.S.C. § 1331's provision for "arising under" jurisdiction, *see Lyeth v. Hoey*, 305 U.S. 188, 194 (1938) (quoting *Burnet v. Harmel*, 287 U.S. 103, 110 (1932) ("[T]he expression of [Congress's] will * * * should be interpreted 'so as to give a uniform application to a nationwide scheme of taxation.'")); *PNC Fin. Servs. Group v. Comm'r*, 503 F.3d 119, 136 (D.C. Cir. 2007) (in cases involving federal tax law, "uniformity among the cir-

cuits is particularly desirable * * * to ensure equal application of the tax system, and to further maintain consistency") (quoting *Wash. Energy Co. v. United States*, 94 F.3d 1557, 1561 (Fed. Cir. 1996) (internal quotation marks omitted)).

Finally, as in *Grable*, the efficiency and expertise that a federal forum familiar with federal tax law would produce is of benefit both to the reporters of federal tax information and to the individuals and entities whose tax liability is reported. *See* 545 U.S. at 315. Furthermore, as in *Grable*, the shareholders have not shown that federal tax claims seeking damages measured by alleged federal tax overpayments constitute more than a "microscopic" portion, *ibid.*, of state court tort claims.

The court of appeals denied federal jurisdiction not because it disputed the significance or prominence of the federal issues in the litigation. *See* App., *infra*, 37a (acknowledging that the federal issue "may very well be" "significant"); *id.* at 38a (assuming, for purposes of assessing the effect on the balance of federal and state judicial responsibilities, that the federal interest was significant); *id.* at 33a (noting that construing federal law as petitioners do would be dispositive of the case). Instead, the court concluded that the "national interest in providing a federal forum for federal tax litigation" that this Court recognized in *Grable*, 545 U.S. at 310, did not apply here based on its application of a multi-factor test, several elements of which required "subjective," "speculative," and "not immediately apparent" determinations, all of which led to the conclusion that a federal interest that "may very well be" significant was not a substantial inter-

est, for purposes of "arising under" jurisdiction. App., *infra*, 33a, 34a, 35a, 37a, 38a, 39a. That cannot be reconciled with this Court's precedent.

First, "jurisdictional rules should be clear." *Lapides v. Bd. of Regents*, 535 U.S. 613, 621 (2002) (citing *Hanover Star Milling Co. v. Metcalf*, 240 U.S. 403, 426 (1916) (Holmes, J., concurring)). *See Grable*, 545 U.S. at 321 (Thomas, J., concurring). The Sixth Circuit's matrix of subjective and objective factors is the polar opposite. Its approach offers neither predictability nor stability in the law, promising to embroil litigants and the federal courts in indeterminate jurisdictional disputes over when a significant federal interest becomes a substantial one, both subjectively and objectively speaking.

Second, the majority relied on the absence of a "federal agency in this dispute." App., *infra*, 31a-32a. It is true that the federal government is not a party to the dispute, but that is also beside the point. Although the IRS was formally named as a party in *Grable* (a third-party defendant) after the case was removed to federal court, nothing in this Court's decision turned on that fact, which was not even mentioned in this Court's opinion, and the quiet title suit could have proceeded only among the private parties.

"Arising under" jurisdiction thus turns upon the issues presented, not the parties. Moreover, when the federal government is a party, federal jurisdiction exists and the case can be removed on other grounds. 28 U.S.C. §§ 1346, 1347, 1361; *see also id.* § 1442. Beyond that, a federal agency – the Internal Revenue Service – is certainly directly implicated in the dispute. Petitioners provided the 1099-DIV forms, with

their allegedly erroneous information, not only to respondents but also to the IRS, and they did so pursuant to the directive of federal law to permit the IRS to determine respondents' federal tax obligations. Petitioners also submitted to the IRS Form 5452 and supporting documentation, which showed petitioners' earnings and profits calculation. *See* Rev. Proc. 75-17, 1975-1 C.B. 677, § 8; Form 5452, *available at* http://www.irs.gov/pub/irs-pdf/f5452.pdf. The IRS has never objected to the tax information provided or the calculations made in determining earnings and profits.

Third, the majority below gave weight to its "subjective view" "that this particular [federal] question is not particularly important to the federal government." App., *infra*, 33a. That was wrong on multiple levels. To begin with, under *Grable*, "arising under" jurisdiction turns upon the substantiality of the federal issue and the appropriateness of a federal forum, 545 U.S. at 310, not the number of cases that can be found on Westlaw enforcing the provision. *See* App., *infra*, 46a (dissenting opinion). Furthermore, the issue is important because, as the dissent explained, the proper interpretation of Section 312(n)(1) affects not just corporate earnings and profits calculations, but also "affects directly how much tax securityholders must pay," *id.* at 45a (dissenting opinion), and when they must pay them.[5]

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[5] While dividends are immediately taxable as income, returns of capital are taxed only upon recognition of capital gains or losses, which occurs when stock is sold. *See* Form 1099-DIV Instructions for Recipients, *available at* http://www.irs.gov/pub/irs-pdf/f1099div.pdf.

Beyond that, the Federal Circuit focused its "importance" inquiry too narrowly. *Grable's* holding rests on the government's "strong interest" in the collection of taxes generally and thus focused on the repercussions of state-court adjudication on the revenue scheme as a whole. *Grable*, 545 U.S. at 315. *Grable* thus focused on the benefits and efficiencies of having not just disputes over notices, but "federal tax matters" generally, in federal court. *Ibid.* The collection of tax revenues is far more substantially implicated by the construction of income-defining provisions in the tax code than by the property foreclosure notice in *Grable*. What the court of appeals overlooked here, in assessing the importance of having substantive tax liability determinations made in federal courts, is that the federal government relies heavily on tax information reported by third parties to ensure compliance with tax laws and, indeed, the IRS intends to increase the role of third party reporting in the future. *See* INTERNAL REVENUE SERVICE, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE 20 (2007), *available at* http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf. Exposing reporting entities and individuals to state-court liability to refund overpaid taxes – which they may or may not ever be able to recoup from the federal fisc – will hinder the government's collection of taxes, because fear of damages actions in state courts unfamiliar with federal tax principles will encourage reporters, as a matter of self-protection, to implement interpretations of the federal tax laws that minimize the individual's tax liability. At a minimum, the Sixth Circuit's open-door invitation to inconsistent

state-court and IRS positions on the meaning of federal tax law, App., *infra*, 1a-48a, will leave entities with federal reporting obligations whipsawed between state-court liability and federal directives, an outcome Congress could not have intended and that would inevitably impair federal revenue collection efforts.

Fourth, the court of appeals reasoned that federal tax law was not sufficiently dispositive in this case. App., *infra*, 33a-34a. But, as the majority below acknowledged, respondents have "certainly staked their claim on this federal issue," *id.* at 30a, and, indeed, "concede that their claim will fail under [petitioners'] interpretation of the [federal tax] statute," *id.* at 31a. There is thus no dispute that, "if [petitioners] complied with the accounting requirements in the statute, then [they] would not be culpable for overstating [their] taxable earnings and profits or misreporting taxable dividends." *Id.* at 5a. Yet the majority found jurisdiction lacking because the shareholders would have to establish additional non-federal elements of their claim. *Id.* at 33a-34a. That is no distinction at all, because plaintiffs in quiet title actions, like those in *Grable*, equally would have to establish non-federal elements to prevail on their claims, such as title or interest. 65 AM. JUR. 2d *Quieting Title and Determination of Adverse Claims* § 69 (2007). The court also underscored that the measurement of damages would entail the complex and individualized determination of numerous questions pertaining to each shareholder's federal tax liability. App., *infra*, 35a-36a. But that enhances, rather than diminishes, the number of important federal elements in the case and

the conclusion that this case "sensibly belongs in a federal court." *Grable*, 545 U.S. at 315.[6]

Finally, the Sixth Circuit's concern with "encumbering the federal courts with these tax-code-related cases," App., *infra*, 39a, defies *Grable's* contrary determination both of congressional intent and the limited impact of recognizing "arising under" jurisdiction over substantial questions of federal tax law that arise in the context of a backdoor federal tax refund action, *see Grable*, 545 U.S. at 310.[7]

II. The Divided En Banc Court Of Appeals' Decision Conflicts With The Decisions Of Other Circuits.

A. The en banc court of appeals' decision squarely conflicts with the holdings of other courts concerning the scope of "arising under" jurisdiction. In sharp contrast to the Sixth Circuit's indeterminate, multifactor matrix of subjective and objective factors, the Federal Circuit has held that "arising under" "jurisdiction extends to any case 'in which * * * the plain-

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[6] The court of appeals also considered relevant the question whether the federal issue will be "controlling over numerous other cases." App., *infra*, 34a. This Court recognized in *Grable* "the national interest in providing a federal forum for federal tax litigation," 545 U.S. at 310, not the national interest in providing a federal forum for federal tax issues that meet some unspecified recurrence threshold.

[7] *Empire Healthchoice Assurance v. McVeigh*, 126 S.Ct. 2121 (2006), offers no refuge for the court of appeals' decision. That case was "poles apart from *Grable*," *id.* at 2137, involving not critical issues of federal tax law, but the "fact-bound and situation-specific" "settlement of a personal-injury action launched in state court, and the bottom-line practical issue is the share of that settlement properly payable to Empire." *Ibid.* (citation omitted).

tiff's right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims.'" *Immunocept, LLC v. Fulbright & Jaworski, LLP*, 504 F.3d 1281 (Fed. Cir. 2007) (quoting *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 809 (1988)).

In *Immunocept*, the plaintiff brought a state law malpractice claim based on alleged errors in the prosecution of a patent. The case required resolution of a dispute over the scope of a patent claim. The Federal Circuit held that the case arose under federal law because federal law was a "necessary element" of the state law claim, and the federal law question thus was "substantial." *Id.* at 1285. The court also noted that "[l]itigants will benefit from federal judges who are used to handling these complicated rules." *Ibid.* *See also Air Measurement Techs., Inc. v. Akin Gump Strauss Hauer & Feld, L.L.P.*, 504 F.3d 1262, 1269 (Fed. Cir. 2007) (citing *Christianson*, 486 U.S. at 809) ("Because proof of patent infringement is necessary to show [the plaintiff] would have prevailed in the prior litigation, patent infringement is a 'necessary element' of [the plaintiff's] malpractice claim and therefore apparently presents a substantial question of patent law conferring § 1338 jurisdiction."). While *Immunocept* rested jurisdiction on 28 U.S.C. § 1338, this Court held in *Christianson* that "arising under" means the same thing in § 1331 and § 1338. 486 U.S. at 808-809.

The Federal Circuit would have found "arising under" jurisdiction in this case. There is no dispute that federal law is a "necessary element" – indeed a criti-

cal and dispositive element – of the shareholders' claims. Moreover, questions of federal tax law, and in particular the proper accounting of construction costs as a component of corporate earnings and profits and thus dividends and capital distributions, can be as complex as questions of federal patent law and "will benefit from federal judges who are used to handling these complicated rules." *Immunocept*, 504 F.3d. at 1285. Indeed, that was exactly what this Court concluded about federal tax questions in *Grable*. *See* 545 U.S. at 315 ("[B]uyers (as well as tax delinquents) may find it valuable to come before judges used to federal tax matters."). The Sixth Circuit, by contrast, would have denied federal jurisdiction over the claims because (i) no federal agency was participating in the suit, (ii) the plaintiffs could lose their case on non-federal grounds, (iii) the disputed federal issue (the scope of a particular patent claim) would control no other cases, and (iv) federal courts could be required to adjudicate a substantial number of patent malpractice claims. Indeed, the Sixth Circuit in the case at hand cited malpractice suits as prototypically excluded from federal court jurisdiction. App., *infra*, 40a.

The Sixth Circuit's decision also sharply conflicts with decisions of the Second and Tenth Circuits. Rather than weighing a long list of subjective and objective factors to determine if a federal question is "substantial," App., *infra*, 31a-35a, the Second and Tenth Circuits have hewed more closely to *Grable* and limited their analyses to determining whether the government has an interest in the federal issue and, more specifically, an interest in "claiming the

advantages thought to be inherent in a federal forum." *Broder v. Cablevision Sys. Corp.*, 418 F.3d 187, 195 (2d Cir. 2005) (quoting *Grable*, 545 U.S. at 313); *see also Nicodemus v. Union Pac. Corp.*, 440 F.3d 1227, 1236-1237 (10th Cir. 2006). The Second and Tenth Circuits have also indicated that, unless a federal issue is "wholly," *Nicodemus*, 440 F.3d at 1236, or "clearly insubstantial," *Broder*, 418 F.3d at 195, then it generally qualifies as substantial for purposes of establishing "arising under" jurisdiction.

In *Nicodemus*, the Tenth Circuit held that "[a] case should be dismissed for want of a substantial federal question only when the federal issue is '(1) wholly insubstantial or obviously frivolous, (2) foreclosed by prior cases which have settled the issue one way or another, or (3) so patently without merit as to require no meaningful consideration.'" 440 F.3d at 1236 (quoting *Wiley v. Nat'l Collegiate Athletic Ass'n*, 612 F.2d 473, 477 (10th Cir. 1979)). Under that test, the court held that a substantial federal question was raised by plaintiffs' allegations that a railroad company that held rights-of-way over plaintiffs' land under federal land-grant statutes had exceeded the scope of its rights and was therefore liable for trespass, unjust enrichment, and slander of title under state law. The court of appeals reasoned that "resolution of the issue in federal court would benefit from 'the advantages thought to be inherent in a federal forum,'" *ibid.* (quoting *Grable*, 440 F.3d at 313), and the issue was substantial because the government had an interest in the issue, *ibid.*

In *Broder*, the Second Circuit similarly focused on the government's interest in "claiming the advan-

tages" of a federal forum and concluded that the federal issue was substantial because the federal "questions involve aspects of the complex federal regulatory scheme * * *, as to which there is 'a serious federal interest in claiming the advantages thought to be inherent in a federal forum,'" and "[t]hese federal issues are not clearly insubstantial." 418 F.3d at 195 (quoting *Grable*, 545 U.S. at 313).

Under the Second and Tenth Circuits' tests, federal question jurisdiction would extend to respondents' tax refund claims because the federal question in the case is substantial and, as this Court established in *Grable*, 545 U.S. at 315, the complex questions, which implicate important federal issues, would benefit from resolution in a federal forum. Indeed, far from being "wholly insubstantial" or "patently without merit," *Nicodemus*, 440 F.3d at 1236, the federal issues pervading the shareholders' claims would directly determine how much revenue is owed to the federal government. Because the interpretation of Section 312(n)(1) affects the amount of taxes owed to the government and the lawsuit as a whole intrudes upon both the federal reporting scheme and the tax refund system, the government's interests would be served by having the case heard in federal court. Moreover, a federal forum would provide at least two major advantages: it would ensure the uniform interpretation of federal tax law and federal tax reporting responsibilities, and having judges experienced in the complexities of federal tax law resolve the federal tax law questions presented in cases that result in binding declarations of federal law would promote judicial efficiency.

By contrast, the Sixth Circuit would have held that federal jurisdiction does not extend to the state law claims in *Broder* and *Nicodemus*. In neither case was a federal agency a participant, and plaintiffs raising such state law claims as those at issue in *Broder* and *Nicodemus* could lose their cases on non-federal grounds. *See Broder*, 418 F.3d at 196 ("It would be unusual for a state-law claim that raised a federal issue not to be subject to *some* conceivable state-law defense.") (emphasis in original). In addition, in neither case was there any indication that the federal question presented would control numerous other cases, and in *Broder*, there was no indication that the federal government viewed the federal issue as "important."

Regardless of which of the four courts of appeals' approach is ultimately correct, the division in circuit law is concrete and, with the en banc ruling here, entrenched. This Court's resolution is needed to bring consistency to the law.

B. This Court's review is also warranted because the decision below conflicts with decisions of other circuits holding that the remedial scheme provided by 26 U.S.C. § 7422 is exclusive and completely preempts state-court remedies. Section 7422 provides that "[n]o suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected," except pursuant to a "duly filed" administrative claim for a tax refund with the IRS. 26 U.S.C.

§ 7422(a). An allegedly aggrieved taxpayer that is dissatisfied with the outcome of the administrative proceeding may bring suit seeking a refund of the tax, but such "[a] suit or proceeding * * * may be maintained only against the United States." *Id.* § 7422(f)(1).

The Fifth, Seventh, and Ninth Circuits have held that Section 7422 completely preempts state law claims against companies that aid the IRS in its collection of taxes and are alleged to have collected amounts in error. *Brennan v. Southwest Airlines Co.*, 134 F.3d 1405 (9th Cir. 1998), *amended without substantive change by* 140 F.3d 849; *Sigmon v. Southwest Airlines Co.*, 110 F.3d 1200 (5th Cir. 1997); *Kaucky v. Southwest Airlines Co.*, 109 F. 3d 349 (7th Cir. 1997). The Sixth Circuit attempted to distinguish those decisions on the ground that the defendants in each case physically collected a tax from the plaintiffs. App., *infra*, 18a-19a. But whether or not the defendant actually handled the checks, the shareholders' suit, like that of the plaintiffs in the Fifth, Seventh, and Ninth Circuits, remains one "for the recovery" of a "sum" that was (allegedly) "wrongfully collected" from them on the basis of a disputed construction of the tax code. Here, as much as in *Brennan*, *Sigmon*, and *Kaucky*, permitting state-court suits against a private party for the recovery of taxes would "throw a monkey wrench into machinery designed to confine suits for the refund of federal taxes to suits in the federal courts against the government in order to protect its private as well as public agents from being whipsawed." *Kaucky*, 109 F.3d at 353.

In language that speaks directly to the Sixth Cir-

cuit's decision here, the Ninth Circuit explained that permitting state court suits for the alleged overpayment of taxes to proceed "might lead to situations in which the collecting agent would be required to refund taxes to the taxpayer but could not recover them from the government," particularly "if the taxpayer is permitted to sue the collecting agent after the statute of limitations for filing refund claims with the government has expired." *Brennan*, 134 F.3d at 1411 (quoting *DuPont Glore Forgan Inc. v. AT&T Co.*, 428 F.Supp. 1297, 1306 (S.D.N.Y. 1977)). Accordingly, the Sixth Circuit's decision that the shareholders' suit does not even raise a "substantial" federal question is in irreconcilable conflict with the Fifth, Seventh, and Ninth Circuits' decisions that the litigation involves federal questions that are so substantial as to be completely preempted by federal law.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully Submitted,

MITCHELL G. BLAIR
COLLEEN MORAN O'NEIL
TRACY SCOTT JOHNSON
CALFEE, HALTER & GRISWOLD LLP
1400 McDonald Investment Center
800 Superior Ave.
Cleveland, OH 44114
(216) 622-8200

THOMAS C. GOLDSTEIN
(Counsel of Record)
PATRICIA A. MILLETT
MONICA P. SEKHON
AKIN GUMP STRAUSS HAUER & FELD, LLP
1333 New Hampshire Ave., NW
Washington, DC 20036
(202) 887-4000

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APPENDIX

APPENDIX

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

JEROME R. MIKULSKI; ELZETTA C. MIKULSKI,
On Behalf of Themselves
and All Others Similarly Situated,

Plaintiffs-Appellants,

v.

CENTERIOR ENERGY CORPORATION;
FIRST ENERGY CORPORATION;
CLEVELAND ELECTRIC ILLUMINATING COMPANY;
THE TOLEDO EDISON COMPANY,

Defendants-Appellees.

No. 03-4486

Appeal from the United States District Court
for the Northern District of Ohio at Cleveland.

Nos. 02-02440; 03-00191; 03-00192; 03-07043

Donald C. Nugent, District Judge.

Argued: September 13, 2006
Decided and Filed: August 21, 2007

Before: BOGGS, Chief Judge; MARTIN, BATCHELDER, DAUGHTREY, MOORE, COLE, CLAY, GILMAN, GIBBONS, ROGERS, SUTTON, McKEAGUE, and GRIFFIN, Circuit Judges.

BATCHELDER, J., delivered the opinion of the court, in which BOGGS, C. J., GILMAN, GIBBONS, ROGERS, SUTTON, McKEAGUE, and GRIFFIN, JJ., joined.

DAUGHTREY, J. (pp. 17-19), delivered a separate opinion concurring in part and dissenting in part, in which MARTIN, MOORE, COLE, and CLAY, JJ., joined.

OPINION

ALICE M. BATCHELDER, Circuit Judge. The issue to be decided in the present case is whether the substantial-federal-question doctrine provides federal subject-matter jurisdiction over a state law claim on the basis that an embedded element of the claim concerns 26 U.S.C. § 312(n)(1), an accounting rule in the federal tax code. We hold that it does not.

I.

Plaintiffs Jerome and Elzetta Mikulski filed a class action suit against Centerior Energy Corporation ("Centerior")[1] in the Cuyahoga County (Ohio) Court of Common Pleas, alleging fraudulent misrepresentation and breach of contract. For ease of introduction, we can ignore certain details until later in the analysis and set out the underpinnings of this case without all their rough edges. Simply put, Centerior interpreted 26 U.S.C. § 312(n)(1) to mean that, beginning with its 1985 fiscal year, it could no longer deduct certain interest expenses from its calculation of taxable earnings. Therefore, Centerior did not deduct these expenses from its earnings, which made Centerior appear more profitable but also increased Centerior's tax liability. Because Centerior declared and distributed dividends based on these reported earnings, the increased tax liability was passed on to its shareholders via IRS forms 1099-DIV.

The plaintiffs contend that Centerior's interpretation of § 312(n)(1), in regard to this particular interest expense, was not only incorrect, but was fraudulent. The plaintiffs accuse Centerior of *intentionally* overstating its earnings and profits during the time periods in question, in order to make itself appear more profitable. In what turned out to be a critical

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[1] The complaint also named Centerior's successor company, First Energy Corporation, as a defendant. Subsequently, the Mikulski plaintiffs filed three additional class-action complaints, asserting identical claims for three other tax years and also naming Cleveland Electric Co. and Toledo Edison as defendants. The district court consolidated the four lawsuits and the defendants are hereafter referred to collectively as "Centerior."

response to an interrogatory, the plaintiffs explained their theory in terms of 26 U.S.C. § 312:

> Section 312(n)(1) states that no construction expenses incurred before January 1, 1985, may be considered in calculating a corporation's earnings and profits.
>
> Centerior [] included in its earnings and profits calculations for 1986 (and subsequent years) more than $1.5 billion of construction expenses that its subsidiaries had incurred in 1984 and earlier. [Therefore,]
>
> Centerior violated the Internal Revenue Code by doing what Section 312(n)(1) of the Code specifically forbids.

Pls.' Supp. Resp. to Interrog. No. 1 of Defs.' Second Set of Interrogs (rearranged from original). To be clear, these "construction expenses" are actually interest expenses on long-term construction loans that span the years in question, which are labeled "construction period carrying charges" in § 312(n)(1). Section 312(n)(1) actually states: "In the case of any amount paid or incurred for construction period carrying charges . . . no deduction shall be allowed with respect to such amount," and there is no date provision in the codified statute. The essential point of this interrogatory response, however, is that it invoked federal law, namely § 312(n)(1), as the basis for the plaintiffs' state law claim. Thus, the plaintiffs' contend, based on this interpretation of § 312(n)(1), that Centerior (by overstating its earnings and profits) misrepresented to its shareholders (via IRS forms

1099-DIV) that their dividends were taxable, which caused those (now plaintiffclass) shareholders to erroneously overpay their federal and state income taxes.

Centerior disputed the plaintiffs' interpretation of § 312(n)(1), particularly its effective date[2] provision, which led to the question of whether § 312(n)(1) applied only to interest expenses actually incurred after January 1, 1985 (as the plaintiffs argued), or if it instead applied to accumulated interest expenses that related to construction projects that remained ongoing after January 1, 1985 (as Centerior had assumed). The plaintiffs concede that their claim will fail under the latter construction; if Centerior complied with the accounting requirements in the statute, then it would not be culpable for overstating its taxable earnings and profits or misreporting taxable dividends.

Centerior removed the case to federal court by asserting, based on the plaintiffs' response to the above-referenced interrogatory, that the complaint raised a substantial federal question, the resolution of which was essential to the disposition of the plaintiffs' claims. The plaintiffs moved for a remand to state

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[2] The effective date was not codified, but was stated in the Act: "The provisions of paragraphs (1), (2), and (3) of section 312(n) of the Internal Revenue Code of 1954 (as added by subsections (a) [of this section of this Act]) shall apply to amounts paid or incurred in taxable years beginning after September 30, 1984." Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 61(e), 98 Stat. 494 (1984). Centerior operates on a calender fiscal year, so the "taxable year beginning after September 30, 1984" was Centerior's fiscal year beginning on January 1, 1985.

court, and the district court denied the motion, finding that the plaintiffs' cause of action, although presented as breach of contract and fraudulent misrepresentation, was actually aimed at a tax refund and raised a substantial federal question involving federal tax law.

Centerior next filed a motion for judgment on the pleadings, arguing that the action was expressly preempted by 26 U.S.C. § 7422, and implicitly preempted by the scope and complexity of the Internal Revenue Code. The district court referred the case to a magistrate judge who recommended judgment on the pleadings and documented three findings. First, the plaintiffs could have raised the issue with the IRS, filed for a refund, or pursued administrative remedies, but they did not. Second, if the court allowed the lawsuit to proceed, then it could be opening the federal courts to litigation by every shareholder for misstatement of earnings and profits, by every employee for overstatement of earnings on W-2 forms, and by every independent contractor for an overstated 1099 form. Third, the Internal Revenue Code was designed to avoid these types of actions and instead allows injured taxpayers to proceed directly against the government for a refund.

The plaintiffs objected to the magistrate judge's report and recommendation, arguing that its principal error was in mischaracterizing their claim as one for a tax refund, which led to the erroneous conclusion that the claims were preempted by federal tax law. At a hearing before the district court, the plaintiffs refuted preemption and once again disputed re-

moval jurisdiction. The plaintiffs emphasized that their suit was based on state law claims for breach of contract and fraud, not the alleged violation of the Internal Revenue Code. The district court rejected the plaintiffs' arguments, adopted the magistrate judge's recommendation, and granted judgment on the pleadings in favor of Centerior. The district court concluded that the complaint relied on the interpretation of the Internal Revenue Code, and therefore jurisdiction was proper based on either preemption or a substantial question of federal law. The district court granted judgment on the pleadings based on the plaintiffs' failure to exhaust their remedies with the IRS.

The plaintiffs appealed to this court on the issue of federal subject-matter jurisdiction. *Mikulski v. Centerior*, 435 F.3d 666, 671 (6th Cir. 2006) (rehearing *en banc* granted, opinion vacated Apr. 26, 2006). The majority reversed, finding that the district court had misapplied both the preemption and the substantial-federal-question doctrines, and consequently lacked subject-matter jurisdiction. The entire panel agreed that the district court had erred in finding the plaintiffs' claims preempted by 26 U.S.C. § 7422. The majority further held that the mere presence of a federal statute as an element of a claim does not present a substantial federal question. The dissent relied on *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005), to argue that the federal government has a substantial interest in the construction of 26 U.S.C. § 312(n)(1) because it affects the amount of federal tax a security

holder must pay.

Centerior petitioned for rehearing *en banc*, asking: "Whether federal question jurisdiction exists over state law claims when plaintiffs' recovery depends upon a contested interpretation of federal tax law?" This court granted the rehearing and vacated the panel opinion.

II.

When a decision on subject-matter jurisdiction concerns pure questions of law or application of law to the facts, this court conducts a *de novo* review. *Rodriguez v. Tenn. Laborers Health & Welfare Fund*, 463 F.3d 473, 475 (6th Cir. 2006). If the district court's jurisdictional ruling was based on the resolution of factual disputes, then we review those findings for clear error. *Golden v. Gorno Bros., Inc.*, 410 F.3d 879, 881 (6th Cir. 2005). The issue before us in this case is primarily a question of law or an application of the law to the given circumstances. The district court produced few factual findings in resolving the jurisdictional question in this case.

This is a case in which Ohio citizens sued an Ohio corporation in Ohio state court, and the defendant corporation removed the case to federal court. Let there be no doubt that the plaintiffs would prefer to be in state court. In the absence of diversity, a defendant may remove a civil action from state court to federal court only if the *plaintiff's* allegations establish "original jurisdiction founded on a claim or right arising under" federal law. 28 U.S.C. § 1441(b). "To determine whether the claim arises under federal law, we examine the 'well pleaded' allegations of the

complaint and ignore potential defenses[.]" *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 6 (2003). Even "a defense that relies on the preclusive effect of a prior federal judgment or the pre-emptive effect of a federal statute will not provide a basis for removal." *Id.* (citations omitted).

There are exceptions to the well-pleaded complaint rule. *Id.* One exception is the artfulpleading doctrine: plaintiffs may not "avoid removal jurisdiction by artfully casting their essentially federal law claims as state-law claims." *Federated Dep't Stores, Inc. v. Moitie*, 452 U.S. 394, 397 n.2 (1981) (quotation marks, citations, and edits omitted). A related exception is the completepreemption doctrine: removal is proper "when a federal statute wholly displaces the state-law cause of action through complete preemption." *Beneficial Nat'l Bank*, 539 U.S. at 8. A third exception is the substantial-federal-question doctrine, which applies "where the vindication of a right under state law necessarily turn[s] on some construction of federal law." *Franchise Tax Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1, 9 (1983). Thus, under limited circumstances, a defendant may force a plaintiff into federal court despite the plaintiff's desire to proceed in state court.

We are mindful that state courts are generally presumed competent to interpret and apply federal law. *See Zwickler v. Koota*, 389 U.S. 241, 245 (1967) ("During most of the Nation's first century, Congress relied on the state courts to vindicate essential rights arising under the Constitution and federal laws."). As the Seventh Circuit recently noted, "there is nothing

unusual about a court having to decide issues that arise under the law of other jurisdictions; otherwise there would be no field called 'conflict of laws' and no rule barring removal of a case from state to federal court on the basis of a federal defense." *Hays v. Cave*, 446 F.3d 712, 714 (7th Cir. 2006). The Supreme Court has explained this rule against removal on the basis of a federal defense:

> Although such allegations show that very likely, in the course of the litigation, a question under the Constitution would arise, they do not show that the suit, that is, the plaintiff's original cause of action, arises under the Constitution. For better or worse, under the present statutory scheme as it has existed since 1887, a defendant may not remove a case to federal court unless the plaintiff's complaint establishes that the case arises under federal law.

Franchise Tax Bd., 463 U.S. at 10 (quotation marks, citations, and edits omitted).

Resolution of this appeal will require an inquiry into the federal interest in having the federal issue decided by a federal court, and we acknowledge this otherwise axiomatic premise — that state courts are competent to interpret and apply federal law — in order to ensure that we do not misconstrue the nature of the federal interest or become misled by some histrionic fear that allowing state courts to decide federal law issues might lead to some disastrous consequence, such as 50 irreconcilable interpretations of

the tax code, a potential race to the bottom, or diminished federal tax revenues. While there is certainly a significant federal interest in avoiding each of these consequences, the simple fact is that these are *not* the types of consequences to be considered by *courts*. The legal analysis that guides this decision does not include consideration of the *effect* of state versus federal adjudication on the outcome of any given case or issue. "[I]t is up to Congress, not the federal courts, to decide when the risk of state-court error with respect to a matter of federal law becomes so unbearable as to justify divesting the state courts of authority to decide the federal matter." *Beneficial Nat'l Bank*, 539 U.S. at 21 (Scalia, J., dissenting). Thus, our inquiry is ultimately one of congressional intent, not policy or personal preference.

III.

Under the artful-pleading doctrine, a federal court will have jurisdiction if a plaintiff has carefully drafted the complaint so as to avoid naming a federal statute as the basis for the claim, and the claim is in fact based on a federal statute. *Franchise Tax Bd.*, 463 U.S. at 22. A defendant raising this doctrine may not rely on facts not alleged in the complaint. *Caterpillar Inc. v. Williams*, 482 U.S. 386, 397 (1987). "Although occasionally [a] removal court will seek to determine whether the real nature of the claim is federal, regardless of plaintiff's characterization, most of them correctly confine this practice to areas of the law pre-empted by federal substantive law." *Id.* at 397 n.11 (quotation marks and edits omitted) (citing *Federated Dep't Stores*, 452 U.S. at 410 n.6 (Brennan,

J., dissenting)). Thus, artful pleading and preemption are closely aligned.

Accepting the possibility that the plaintiffs may have carefully structured their complaint to avoid federal jurisdiction, we consider whether the facts alleged in the complaint actually implicate a federal cause of action. The plaintiffs have asserted two state, common-law causes of action: breach of contract[3] and fraudulent misrepresentation.[4] The complaint specifies, in pertinent part:

> 23. . . . A shareholder's stock certificate constitutes a written contract with the issuing corporation.
>
> 24. Pursuant to relevant provisions of the Internal Revenue Code, including [] Section 6042(c), a corporation paying divi-

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[3] Under Ohio law, the elements of a common law breach of contract are (1) that a contract existed, (2) that the plaintiff fulfilled his obligations, (3) that the defendant unlawfully failed to fulfill his obligations, and (4) that damages resulted from this failure. *Lawrence v. Lorain County Cmty. Coll.*, 713 N.E.2d 478, 480 (Ohio App. 1998).

[4] Under Ohio law, the elements of common law fraudulent misrepresentation are: "(a) a representation or, where there is a duty to disclose, concealment of a fact, (b) which is material to the transaction at hand, (c) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (d) with the intent of misleading another into relying upon it, (e) justifiable reliance upon the representation or concealment, and (f) a resulting injury proximately caused by the reliance." *Burr v. Stark County Bd. of Comm'rs*, 491 N.E.2d 1101, 1102 (Ohio 1986) (paragraph two of the syllabus).

dends to its shareholders is obligated to issue an accurate [IRS] Form 1099-DIV (or a substitute form) to its shareholders.

28. Thus, by virtue of its written contract with its shareholders, Centerior was contractually required accurately to report dividends and returns of capital to every shareholder. To the extent such contractual obligations may not be specifically stated in the written contract, such contractual terms are implied by operation of law.

29. Centerior breached its written contract with the Plaintiff class [] by misreporting to class members [] the portion of the 1986 distributions which constituted taxable dividends and the portion which constituted a return of capital.

30. Furthermore, in order for Centerior to fulfill its contractual obligation accurately to report shareholder dividends and returns of capital, Centerior had the additional obligation accurately to calculate its earnings and profits and the E&P of its subsidiaries.

31. Centerior also breached its written contract with the Plaintiff class [] when it inaccurately calculated earnings and profits for purposes of determining the portion of 1986 distributions which constituted taxable dividends, and thereby understated that portion of the distributions which constituted a return of capital.

> 32. *Centerior's misreporting* caused the members of the Plaintiff class [] to overpay their respective income taxes for 1986 and all other relevant periods.
>
> 33. As a direct and proximate result of such overpayment, the members of the Plaintiff class [] have been damaged in the amount of such overpayment, which damages can be calculated for each class member [] on a class-wide basis.

So, both causes of action rely on the same premise: that Centerior overstated the amount of taxable dividends it distributed in 1986 (and three other years), which caused its shareholders to overpay their federal and state income taxes. Importantly, the plaintiffs do *not* state or imply a federal Securities Exchange Act claim, in which investors allege that they were harmed through the purchase or sale of mispriced shares.[5] These plaintiffs allege a traditional tort and breach of contract.

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[5] The plaintiffs clarified their claims in a key interrogatory response, which demonstrates that, under their particular theory, their alleged harm is actually incidental to the alleged wrong: From its formation in 1986, [Centerior] deliberately and fraudulently manipulated its tax accounting practices over a period of years in order to artificially inflate its 'earnings and profits' so that it would look more profitable to its investors. This was vitally important to Centerior in 1986 because it needed to justify the recent merger of CEI and Toledo Edison. In the process, however, Centerior defrauded some 200,000 shareholders who lost more than $35 million from being wrongly instructed by Centerior to pay too much in federal income taxes on their 1986 distributions alone. Pls.' Supp. Resp. to Interrog. No. 1 of Defs.' Second Set of Interrogs. (footnote omitted). . . .

In July 1996, Congress enacted 26 U.S.C. § 7434 as part of the Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996), and created a private cause of action against anyone "who willfully files a fraudulent information return" (e.g., IRS form 1099-DIV) that causes injury to the purported recipient. This appears to provide a federal cause of action under the facts alleged in the complaint, but because all of the events giving rise to the plaintiffs' claims preceded the enactment of § 7434 by almost ten years, § 7434 would be unavailable to these plaintiffs for these claims. Furthermore, neither this section of the statute nor the Act itself contains any indication that Congress intended it to be the exclusive remedy for a fraudulent overstatement of taxable dividend distributions, so the plaintiffs' claims do not necessarily state a federal claim.

Congress enacted 26 U.S.C. § 312 as part of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984), and § 312 governs certain earnings-and-profits calculations. According to the plaintiffs' complaint, the *reason* Centerior overstated the taxable portion of the distributions (i.e., dividends) was because it miscalculated its earnings and profits. Under the Internal Revenue Code, if a corporation has earnings and profits, then distributions to shareholders are considered *taxable* "dividends" up to the amount of the earnings and profits. 26 U.S.C. § 316(a). But if distributions exceed earnings and profits, then the distributions are considered *tax-free* "returns of capital." *See Lewis v. CIR*, 18 F.3d 20, 23 (1st Cir. 1994); *Luckman v. CIR*, 418 F.2d 381, 383 (7th

Cir. 1969). While we agree that § 312 affects the measure and calculation of a corporation's earnings and profits, it is only a guideline or instruction on proper tax accounting practices. It does not include a civil suit provision or implicitly create a private cause of action. Similarly, 26 U.S.C. § 6042, which governs the reporting of dividend payments and the reporting of earning and profit calculations, does not state or imply a private cause of action either.

Therefore, we must conclude that the Mikulski plaintiffs would not have had a federal, statutory cause of action against Centerior on these or similar claims; that is, none of these statutes provides a federal cause of action that might have been invoked by a less artfully drafted complaint. We cannot conclude under these facts that the plaintiffs carefully drafted their complaint to avoid a federal statute or federal cause of action. *See Franchise Tax Bd.*, 463 U.S. at 22.

IV.

The complete-preemption doctrine applies in circumstances in which Congress may intend the preemptive force of a federal statute to be so extraordinary that "any claim purportedly based on that preempted state law is considered, from its inception, a federal claim, and therefore arises under federal law." *Caterpillar*, 482 U.S. at 393. The Supreme Court has found complete preemption in only three classes of cases: Section 301 of the Labor Management Relations Act of 1947 (LMRA), 29 U.S.C. § 185; the Employee Retirement Income Security Act of 1975 (ERISA), 29 U.S.C. §§ 1001-1461; and the Na-

tional Bank Act, 12 U.S.C. § 38. *See Beneficial Nat'l Bank*, 539 U.S. at 7-9. Complete preemption requires a finding that "the federal statutes at issue provided the exclusive cause of action for the claim asserted and also set forth procedures and remedies governing that cause of action." *Id.* at 7-8. To date, the Supreme Court has not found complete preemption over claims that allege misreporting by corporations to their taxpaying shareholders.

This circuit has recognized that complete preemption is a limited rule. Although we held that the National Flood Insurance Act, 42 U.S.C. § 4072, completely preempts state law because it explicitly confers "original exclusive jurisdiction" on the federal district courts, *Gibson v. Am. Bankers Ins. Co.*, 289 F.3d 943, 947 (6th Cir. 2002), we have declined to extend complete preemption to various statutes that lack similarly explicit language. *See, e.g.*, *Wellons v. Nw. Airlines, Inc.*, 165 F.3d 493, 496 (6th Cir. 1999) (denying complete preemption under the Airline Deregulation Act); *Musson Theatrical, Inc. v. Fed. Express Corp.*, 89 F.3d 1244, 1253 (6th Cir. 1996) (Airline Deregulation Act); *Strong v. Telectronics Pacing Sys., Inc.*, 78 F.3d 256, 259 (6th Cir. 1996) (Medical Device Amendments to Federal Food, Drug, and Cosmetic Act); *Gustafson v. Lake Angelus*, 76 F.3d 778, 783 (6th Cir. 1996) (Federal Aviation Act).

Congress has not created an exclusive federal remedy under the Internal Revenue Code for the miscalculation of earnings and profits or the misreporting of taxable dividends. Congress knows how to enact exclusive private rights of action when it

chooses to do so, *see Cent. Bank v. First Interstate Bank*, 511 U.S. 164, 176-77 (1994), and several provisions in the tax code expressly prescribe an exclusive, private federal remedy. *See, e.g.*, 26 U.S.C. § 6110(j)(1)(B) ("shall have as an exclusive federal remedy"); 26 U.S.C. § 897(i)(4) ("the exclusive remedy for any person claiming"); 26 U.S.C. § 7433(a) ("such civil action shall be the exclusive remedy"); 26 U.S.C. § 7433(e)(2)(A) ("petition shall be the exclusive remedy"). In contrast, neither of the provisions relied upon by the Mikulski plaintiffs, 26 U.S.C. § 312(n)(1) or § 6042(c), contains any express statement of an exclusive federal remedy. Even 26 U.S.C. § 7434, which creates a private right of action against a company submitting a fraudulent information return, does not purport to be exclusive.

Under 26 U.S.C. § 7422(a), no private action "shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or . . . of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary." This provision was intended to provide taxpayers with a means to obtain relief from improper collections by tax collectors while also protecting government collection officers from being sued by taxpayers. *See* S. Rep. No. 89-1625 (1966), *reprinted in* 1966 U.S.C.C.A.N. 3676, 3681-82. We find no indication that Congress intended this tax refund procedure to be a security holder's exclusive remedy for a company's misreporting of dividends. *Id.* Although the federal courts have

broadened § 7422 in the "airline cases" and applied it to airlines that effectively act as agents for the IRS by collecting excise taxes from passengers, *see, e.g.*, *Brennan v. Sw. Airlines Co.*, 134 F.3d 1405, 1409 (9th Cir. 1998); *Sigmon v. Sw. Airlines Co.*, 110 F.3d 1200, 1203 (5th Cir. 1997); *Kaucky v. Sw. Airlines Co.*, 109 F.3d 349 (7th Cir. 1997), that expansive application does not extend to the present case because Centerior did not collect or withhold any taxes. Centerior was not acting as a collection agent for or on behalf of the IRS. *See In re Air Transp. Excise Tax Litig.*, 37 F. Supp. 2d 1133, 1137 (D. Minn. 1999) (limiting the applicability of the airline cases to their unique circumstances).

The mere fact that the plaintiffs' damages are calculated in terms of overpaid income taxes does not necessitate the conclusion that the plaintiffs' claim must actually be one for a federal income tax refund. *Cf. Marks v. Newcourt Credit Group, Inc.*, 342 F.3d 444, 453 (6th Cir. 2003) (the underlying damages do not dictate the nature of a plaintiff's claim). This is especially so for the claim of *state* income taxes — the plaintiffs' alleged overpayment of *state* income taxes obviously does not assert a federal income tax refund claim. Perhaps more to the point, however, is that the plaintiffs are not seeking a tax refund inasmuch as they are not accusing the IRS of any wrongdoing. Under the plaintiffs' theory, the IRS was an innocent third-party, who, like the plaintiffs themselves, merely relied on the 1099-DIVs issued by Centerior, while Centerior was the active (i.e., liable) tortfeasor. *See Anza v. Ideal Steel Supply Corp.*, 547 U.S. --, 126

S. Ct. 1991, 2003-04 (2006) (Thomas, J., concurring) (noting that "courts have historically found proximate causation . . . [even] for injuries where an innocent third party intervenes between the tortfeasor and the victim, such that the innocent third party is the immediate cause of the injury" (citation and emphasis omitted)). The same reasoning applies to the plaintiffs' breach of contract claim. We therefore conclude that 26 U.S.C. § 7422 does not preempt the present case.

The plaintiffs' claims are not completely preempted by federal law and the district court erred by concluding that they were. We find no basis for federal subject-matter jurisdiction based on the well-pleaded complaint, the artful-pleading doctrine, or complete preemption.

V.

Under the substantial-federal-question doctrine, a state law cause of action may actually arise under federal law, even though Congress has not created a private right of action, if the vindication of a right under state law depends on the validity, construction, or effect of federal law. *See Franchise Tax Bd.*, 463 U.S. at 9; *Shulthis v. McDougal*, 225 U.S. 561, 569 (1912). "As an initial proposition, then, the 'law that creates the cause of action' is state law, and original federal jurisdiction is unavailable unless it appears that some substantial, disputed question of federal law is a necessary element of one of the well-pleaded state claims, or that one or the other claim is 'really' one of federal law." *Franchise Tax Bd.*, 463 U.S. at 13. The mere presence of a federal issue in a state

law cause of action does not automatically confer federal question jurisdiction, either originally or on removal. Such jurisdiction remains exceptional and federal courts must determine its availability, issue by issue. The Supreme Court has developed a standard, through an evolving case line, by which the federal interest in providing a forum for an issue is weighed against the risk that the federal courts will be unduly burdened by a rush of state law cases.

In *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 199 (1921), the Supreme Court first acknowledged that federal jurisdiction may exist over an ordinary state-law cause of action where "the right to relief depends upon the construction or application of the Constitution or laws of the United States, and that such federal claim is not merely colorable." In *Smith*, a shareholder sued in federal court to prevent a company's directors from breaching their duty to the shareholders, as set out by the state's laws of incorporation. *Id.* at 214 (Holmes, J., dissenting). Specifically, the plaintiff alleged that the Federal Farm Loan Act was unconstitutional, and therefore, an investment in bonds issued under that Act would result in a defendant's breach of duty. *Id.* at 198. The Supreme Court, raising the jurisdictional question *sua sponte*, ultimately determined that federal jurisdiction was proper because of the significant federal interest in determination of the constitutionality of a federal statute. *Id.* at 201-02. Subsequent cases have narrowed and refined the rule.

In *Moore v. Chesapeake & Ohio Railway Co.*, 291 U.S. 205, 208 (1934), a railroad employee sued his

employer under the Kentucky Employers' Liability Act, alleging that he was injured by defective equipment. Under the state law, a violation of the Federal Safety Appliance Acts constituted negligence *per se* and eliminated the defenses of contributory negligence and assumption of risk. *Id.* at 212-13. The Supreme Court determined that federal jurisdiction was lacking because the federal interest in a state law tort action was not significant. "The action fell within the familiar category of cases involving the duty of a master to his servant . . . . The Federal statute, in the present case touched the duty of the master at a single point, and . . . the right of the plaintiff to recover was left to be determined by the law of the state." *Id.* at 216-17.

Therefore, in the early cases, the Court decided substantial-federal-question jurisdiction based solely on the magnitude of the federal interest. These two cases in particular highlight a distinction between the *significant* federal interest in deciding the constitutionality of a federal statute, a potential rebuke of congressional authority, as compared with the *minimal* federal interest in the shaping of the scope of a state statutory duty, a task likely to recur routinely and repeatedly. The Court has since added another dimension: the desire to protect the federal courts from the burden of excessive litigation that is better suited to state courts.

In *Merrell Dow Pharmaceuticals Inc. v. Thompson*, 478 U.S. 804, 805-06 (1986), the plaintiffs sued a drug company on a state law tort claim, alleging that the drug company was presumptively negligent be-

cause it had violated the branding provision of the federal Food, Drug, and Cosmetic Act. In what appeared to be a departure from the federal-interest-based approach, the Court introduced new factors, explaining that "the very reasons for the development of the modern implied remedy doctrine — . . . [including] the increased volume of federal litigation . . . — are precisely the kind of considerations that should inform the [substantial-federal-question decision]." *Id.* at 811 (quotation marks and citations omitted). Under this approach, the Court placed significant emphasis on the absence of a federal statutory cause of action: "the congressional determination that there should be no federal remedy for the violation of this federal statute is tantamount to a congressional conclusion that the presence of a claimed violation of the statute as an element of a state cause of action is insufficiently substantial to confer federal-question jurisdiction." *Id.* at 814 (quotation marks omitted). Based primarily on the absence of a "private, federal cause of action," the Court concluded that federal jurisdiction was lacking. *Id.* at 817.

In *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. at 310-11, the plaintiff filed a state law claim to quiet title, alleging that the defendant's record title was invalid because the IRS, in seizing the plaintiff's property to satisfy a federal tax deficiency, had failed to give the plaintiff proper notice pursuant to 26 U.S.C. § 6335(a). Although the complaint did not set forth a federal cause of action, the Court recognized that the state law claim presented a question of federal law.

But this recognition did not end the inquiry as to whether the action "arose under" federal law; it triggered further considerations. The Court observed, "the presence of a disputed federal issue and the ostensible importance of a federal forum are never necessarily dispositive; there must always be an assessment of any disruptive portent in exercising federal jurisdiction [i.e., in the balance of federal and state judicial responsibilities]." *Id.* at 314.

In *Grable*, the Supreme Court, for the first time, brought its two concerns together into a single standard, which it described as "the framework of examining the importance of having a federal forum for the issue, and the consistency of such a forum with Congress's intended division of labor between state and federal courts." *Id.* at 319. The Court then recognized that *Grable*'s particular federal issue implicated the ability of the federal government (i.e., the IRS) "to vindicate its own administrative action." *Id.* at 315. The Court also acknowledged that the rarity of this issue would "portend only a microscopic effect on the federal-state division of labor." *Id.*

Because 26 U.S.C. § 6335(a), the federal tax code provision at issue in *Grable*, did not provide for a private, federal cause of action, the Court was compelled to reconcile its decision with its earlier opinion in *Merrell Dow*. *Id.* at 316-19. To do this, the Court introduced the "welcome mat" metaphor:

> [*Merrell Dow*] saw the missing cause of action not as a missing federal door key, always required, but as a missing welcome mat, required in the circumstances,

when exercising federal jurisdiction over a state [] action would have attracted a horde of original filings and removal cases raising other state claims with embedded federal issues. For if the federal labeling standard without a federal cause of action could get a state claim into federal court, so could any other federal standard without a federal cause of action. And that would have meant a tremendous number of cases.

One only needed to consider the treatment of federal violations generally in garden variety state tort law. The violation of federal statutes and regulations is commonly given negligence per se effect in state tort proceedings. A general rule of exercising federal jurisdiction over state claims resting on federal [] statutory violations would thus have heralded a potentially enormous shift of traditionally state cases into federal courts. Expressing concern over the increased volume of federal litigation, and noting the importance of adhering to legislative intent, *Merrell Dow* thought it improbable that the Congress, having made no provision for a federal cause of action, would have meant to welcome any state-law tort case implicating federal law solely because the violation of the federal statute is said to create a rebuttable presumption of negligence

> under state law. In this situation, no welcome mat meant keep out. *Merrell Dow*'s analysis thus fits within the framework of examining the importance of having a federal forum for the issue, and the consistency of such a forum with Congress's intended division of labor between state and federal courts.

Id. at 318-19 (internal quotation marks, citations, footnotes, and edits omitted). The *Grable* Court held that, in regard to the IRS's pre-seizure notice provision, as implicated by a quiet title action, the balance favored federal jurisdiction. *Id.* at 319-20.

In *Empire HealthChoice Assurance, Inc. v. McVeigh*, 547 U.S. --, 126 S. Ct. 2121, 2126-27 (2006), the plaintiff was a health plan administrator operating pursuant to the Federal Employees Health Benefits Act who sued to share in the defendant's damage award obtained in a state court personal injury suit. The Court did not shut the jurisdictional door propped open in *Grable*, but it made clear that *Grable* is to be read narrowly: "*Grable* emphasized that it takes more than a federal element to open the 'arising under' door. This case cannot be squeezed into the slim category *Grable* exemplifies." *Id.* at 2137 (internal quotation marks omitted). The Court also summarized the factors that established the significance of the federal interest in *Grable*: "The dispute there [1] centered on the action of a federal agency (IRS) and its compatibility with a federal statute, [2] the question qualified as 'substantial,' and [3] its resolution was both dispositive of the case and [4] would be

controlling in numerous other cases." *Id.* The Court found federal jurisdiction lacking in *Empire* because the state-court tort action was between private parties, the federal issue did not dispose of the case (i.e., "the bottom line practical issue is the share of the settlement properly payable to Empire"), and the federal issue was too "fact-bound and situation-specific" for its resolution to affect numerous other cases. *Id.*

The plaintiffs in the present case seek to rely on Centerior's violation of an accounting provision in the federal tax code to demonstrate that Centerior is liable for fraudulent misrepresentation or breach of contract. From this perspective, the present case most closely resembles *Merrell Dow*'s presumption of negligence for violating the branding provision of the federal Food, Drug, and Cosmetic Act or *Moore*'s application of negligence *per se* for violating the terms of the Federal Safety Appliance Acts, neither of which supported substantial-federal-question jurisdiction. But the present case does not raise a question of mere compliance or noncompliance with a federal statute; the question concerns the meaning of the statute, specifically, the effective date provision. From this perspective, the present case more closely resembles *Smith*'s conclusive determination or *Grable*'s decisive guidance on future application, both of which supported substantial-federal-question jurisdiction. But, unlike *Smith*, the present case does not challenge the constitutionality of the statute, and unlike *Grable*, it does not affect the manner in which the IRS might vindicate its own administrative actions.

We must consider this case in "the framework of examining the importance of having a federal forum for the issue, and the consistency of such a forum with Congress's intended division of labor between state and federal courts." *Grable*, 545 U.S. at 319. The substantial-federalquestion doctrine has three parts: (1) the state-law claim must necessarily raise a disputed federal issue; (2) the federal interest in the issue must be substantial; and (3) the exercise of jurisdiction must not disturb any congressionally approved balance of federal and state judicial responsibilities. *Id.* at 314; *accord Eastman v. Marine Mech. Corp.*, 438 F.3d 544, 552 (6th Cir. 2006).

1.

The plaintiffs' theory certainly appears to raise a disputed federal issue: whether 26 U.S.C. § 312(n)(1) requires capitalization of only those interest expenses actually incurred after the effective date (as the plaintiffs argue), or if it instead requires capitalization of all accumulated interest expenses associated with construction projects that were ongoing as of the effective date (as Centerior had assumed). The plaintiffs' theory is actually a bit complicated, and this shorthand rendition is convenient but incomplete. The plaintiffs produced an expert report that offered a more precise explanation of the theory, although even this is still decidedly murky:

> By 'capitalize', I mean that for purposes of calculating E&P [i.e., earnings and profits], the interest expense attributable to a certain construction project would not be deducted [from the tabulation of E&P], but

[instead would be] added to the cost of the asset being constructed until completion of the project. . . .

Prior to 1983, corporations were not required to capitalize interest on property under construction[;] the interest was deducted [from E&P] as a current expense[]. Under Section 207 of the Tax Equity and Responsibility Act of 1982, corporations were required to capitalize [(i.e., not deduct from E&P) the] interest on nonresidential real estate construction that began after 1982.

In 1984, Congress amended the IRC and added Section 312(n)(1) to prohibit corporations from deducting [this interest] (and other carrying costs) [from E&P]. The provision was effective for 'amounts paid or incurred in taxable years beginning after September 30, 1984' (Section 61(e)(1)(A) of P.L. 98-369)

. . . .

According to the effective date provisions of Section 312(n)(1), interest capitalization was required on [Centerior's] post-1984 construction expenditures. However, [Centerior] capitalized interest on at least $1.5 billion in construction expenditures made *before* 1985 [which was not required by § 312(n)(1)]. As a result, [Centerior] capitalized significantly more [interest] than required by law and overstated E&P

> for 1985 and 1986 by corresponding amounts.
>
> Since E&P is the source of payment for taxable dividends to shareholders, a significant[ly] overstated E&P would very likely cause a corporation to report distributions to shareholders as their taxable incomes [i.e., dividends], when in fact the shareholders were returned capital investment. As a consequence, shareholders overstated their taxable income and tax liabilities.

Pls.' Supp. Resp. to Interrog. No. 1 of Defs.' Second Set of Interrogs. - Exhibit B (Expert Report).

For our purposes, we can abbreviate the plaintiffs' claim anew: Centerior is alleged to have improperly capitalized (i.e., included in its statements of taxable earnings) some $1.5 billion in pre- 1985 construction expenses (interest) on the belief that it was required to do so by § 312(n)(1), while the plaintiffs argue that § 312(n)(1)'s effective date provision excludes any pre-1985 expenses from its capitalization requirement (i.e., the tax code prohibited Centerior from including these expenses in its statements of taxable earnings). Whether due to the parties' confusing descriptions of the issue, the inconsistencies in the language used (i.e., "required" and "prohibited"), or the fact that tax accounting sometimes appears to be a form of modern-day alchemy, it is difficult to frame this dispute with particularity. The plaintiffs have certainly staked their claim on this federal issue, however, and the parties have "crossed swords over

it." *Cf. Arbaugh v. Y&H Corp.*, 546 U.S. 500, 126 S. Ct. 1235, 1243 (2006). Moreover, the plaintiffs concede that their claim will fail under Centerior's interpretation of the statute. We therefore have little difficulty in concluding that there is a federal issue and it is actually disputed.

2.

The second component is the substantiality of the federal interest. *See Grable*, 545 U.S. at 314. The Supreme Court has identified four aspects of a case or an issue that affect the substantiality of the federal interest in that case or issue: (1) whether the case includes a federal agency, and particularly, whether that agency's compliance with the federal statute is in dispute; (2) whether the federal question is important (i.e., not trivial); (3) whether a decision on the federal question will resolve the case (i.e., the federal question is not merely incidental to the outcome); and (4) whether a decision as to the federal question will control numerous other cases (i.e., the issue is not anomalous or isolated). *See Empire*, 126 S. Ct. at 2137 (analyzing *Grable*, 545 U.S. at 313). While certain of these factors may be more applicable than others in any given set of circumstances, no single factor is dispositive and these factors must be considered collectively, along with any other factors that may be applicable in a given case. In this analysis, we address each factor in turn, and consider them in aggregate. Based on our considered judgment of these factors, we ultimately conclude that the federal interest in the present issue is not substantial.

The first factor is both objective and apparent,

and in this case it weighs against characterizing the federal interest as substantial because there is no federal agency in this dispute. *See Empire*, 126 S. Ct. at 2137 ("The dispute [in *Grable*] centered on the action of a federal agency (IRS) and its compatibility with a federal statute[.]"). Section 312(n)(1) imposes a duty on citizens (e.g., corporations), not the federal government (or a government agency), and this case involves no question of whether a government agency has complied with a statute or regulation. *See id.* While the federal government may have an interest in the uniform application of regulations that relate to the collection of taxes, it has only a limited interest in private tort or contract litigation over the private duties involved in that collection. *See Grable*, 545 U.S. at 319. The government's ability to collect taxes from an individual shareholder or a corporation is not affected by the resolution of the dispute between these two parties. The government is free to interpret and apply the tax code as it sees fit, without the slightest regard for this lawsuit. Unlike *Grable*, in which the IRS's prevailing practice was alleged to violate due process, this case will have no *res judicata* effect that would apply to the IRS, no matter which court, federal or state, decides the case. In fact, the IRS even has the authority to vindicate its interest by issuing a formal interpretation of this statute via administrative rule making, if it chooses to do so. *See, e.g.*, Staff of the J. Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Tax Reform Act of 1984 177 (Comm. Print 1984) ("It is anticipated that regulations will be issued provid-

ing for the allocation of expenditures to the construction period and among different properties.").

The second factor is far more subjective and requires that we decide whether the question to be resolved is important. *See Empire*,126 S. Ct. at 2137. To be sure, resolution of this issue will require the analysis and interpretation of federal law, specifically the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 61(e), 98 Stat. 494 (1984), and 26 U.S.C. § 312. But the specific question at issue concerns only the interpretation of the effective date of an accounting provision that instructs companies on how to adjust their earnings and profits calculations to account for certain construction project interest expenses. This question does not implicate any broader or more substantial issue. The question does not necessarily even resolve all aspects of the present case, and it will provide little if any precedent for future cases. In the 22 years since its enactment, the IRS has never issued a rule to interpret the provision, nor — so far as we are aware — has the IRS ever litigated an action involving this provision. Based on our subjective view of this issue, we find it more likely than not that this particular question is not particularly important to the federal government.

The third factor is objective though the answer is not immediately apparent: whether resolution of this question is dispositive of this case. It is not. *See Empire*, 126 S. Ct. at 2137. Resolution of this question is dispositive if decided in favor of Centerior, but only because the plaintiffs have conceded as much. If the plaintiffs prevail on their construction of § 312(n)(1),

and show that Centerior miscalculated earnings and profits due to its violation of § 312(n)(1), then the plaintiffs must still prove the remaining elements of fraudulent misrepresentation (such as intent) or breach of contract (such as the existence of a contract).[6] *See* fns. 3 & 4, *supra*. If, on the other hand, Centerior prevails on its construction and shows that it complied with § 312(n)(1) in calculating its earnings and profits accurately, then the plaintiffs cannot prevail (unless they demonstrate some other misrepresentation or breach of contract). Therefore, conformity with § 312(n)(1) may, but will not necessarily, conclude the action.

Finally, the fourth factor is again subjective and, as touched upon in the discussion of the second factor, we find that a decision on this particular and very narrow question will not be controlling over numerous other cases.[7] *See Empire*, 126 S. Ct. at 2137. The disputed provision applies only to "construction period carrying charges," a special category of con-

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[6] Furthermore, even if the plaintiffs prevail, and § 312(n)(1) is held to exclude pre-1985 expenses from its capitalization requirement, might Centerior nonetheless legitimately reply that § 312(n)(1) does not *forbid* that capitalization either — it merely fails to require it? Or, might Centerior rely on the reasonableness of its interpretation to disprove a culpable mental state, and thereby still avoid liability?

[7] This factor, which concerns whether a decision on the particular federal question at issue in the litigation will set precedent that will control numerous other cases, is not to be confused with the analysis in Section V.3, *infra*, which concerns whether our holding on the availability of federal subject-matter jurisdiction will set precedent that will affect the jurisdiction of numerous other similarly situated cases.

struction costs that includes "interest paid or accrued[,] on indebtedness [that is] incurred or continued [in order] to acquire, construct, or carry property." 26 U.S.C. § 312(n)(1)(B)(i). Furthermore, the particular issue concerns the effective date of September 30, 1984 — some 22 years ago. Finally, "[i]f costs must be capitalized under other provisions of the Internal Revenue Code, then section 312(n)(1) is not applicable." *Von-Lusk v. CIR*, 104 T.C. 207, 220 (1995). Since 1986, corporations such as Centerior have been required to capitalize interest expenses in order to calculate taxable income. 26 U.S.C. § 263A. Thus, the adjustment prescribed by § 312(n)(1) has been at least partially superseded.

Whether the interpretation of § 312(n)(1) is resolved in state court or federal court, the outcome will be the same: companies will report taxable dividends in the manner prescribed by law (i.e., as legislated by Congress and interpreted by the courts). The IRS undoubtedly has an interest in collecting taxes, and it is of no consequence to the IRS whether this case, or any like it, is resolved in federal court rather than the state court. The IRS's ability to collect taxes in accordance with the law is unaffected by the judicial forum. This leads us to our final point on federal interest: § 312(n)(1) does not *control* the IRS's collection of the plaintiffs' income taxes. While § 312(n)(1) may *affect* a shareholder's tax obligations, it will only do so under particular circumstances.

Throughout this case, this appeal, and this opinion to this point, one aspect of the plaintiff's position has generally been accepted: that each shareholder

suffered the same damages, which can be measured by the alleged overpayment of state and federal income taxes. Although the district court certified the shareholders as a plaintiff class and the presumption of identical damages has not been challenged, this presumption is highly suspect, and to the extent that this suspect presumption is relied upon or overlooked in this analysis, the true situation is worth acknowledging. Each of the individual shareholders presumably, at least theoretically, falls within a particular (differing) income tax bracket, holds a unique investment portfolio (with different gains, losses, deductions, offsets, writeoffs, tax shields, etc., in any given year), and consequently, pays a different amount of taxes. While the receipt of non-taxable money (i.e., return of capital) is almost always better than taxable money (i.e., dividends), this simple distinction does not automatically lead to an identical effect on each individual shareholder's overall tax obligation, given the complexity of the tax code (and the creativity of tax accountants). For instance, corporate investors pay a lower effective tax rate on dividends than do individual investors. Pension funds and nonprofits do not pay taxes on dividends, so for them, the difference is irrelevant for tax purposes. This simple distinction is merely intended to demonstrate that the classification of distributions as taxable dividends, rather than non-taxable returns on capital, does not directly control the payment or collection of personal income taxes.

In concluding this section, we find that each of the four factors identified by the Supreme Court draws

us towards a determination that the federal interest in the present issue is not substantial. Taking all four factors into consideration, and acknowledging two unassailable truths — (1) that state courts are fully competent to decide this question, and (2) that § 312(n)(1) does not control the collection of the plaintiffs' personal income taxes *directly* — we conclude that the federal interest in this case is not so substantial that it compels a finding that these traditional state law claims actually "arise under" federal law; not without some statement to that effect by Congress.

This is not to say that there is no federal interest or even some significant federal interest; there may very well be, and it might not be difficult to find. But such a finding would be immaterial. The pertinent finding, which leads to our present conclusion, is that the federal interest in this case is not "substantial" as that term has been defined under the prevailing Supreme Court precedent. *See Empire*, 126 S. Ct. at 2137; *Grable*, 545 U.S. at 315; *Moore*, 291 U.S. at 216-17; *Smith*, 255 U.S. at 201-02. If a case could be deemed to "arise under" federal law — and thereby invoke federal jurisdiction — *any time* the litigation involves the interpretation of a provision in the federal tax code, then these precedents — particularly *Grable* — would be meaningless insofar as they attempt to define a federal interest (or to guide the inquiry into Congressional delegation of responsibility). Indeed, the portions of the tax code that expressly provide for a *federal* remedy would be little more than surplusage. We therefore think it would be im-

prudent to assume that either Congress or the Supreme Court intended such an expansive or limitless view of federal jurisdiction.

3.

Even if there were a significant federal interest, we find that the exercise of jurisdiction over this type of lawsuit would impermissibly disrupt the congressionally approved balance of federal and state judicial responsibilities. *See Grable*, 545 U.S. at 315. Congress has made no provision for a federal cause of action under § 312(n)(1). As the Supreme Court explained in *Grable*, "*Merrell Dow* thought it improbable that the Congress, having made no provision for a federal cause of action, would have meant to welcome any state-law tort case implicating federal law solely because the violation of the federal statute is said to create a rebuttable presumption of negligence under state law. In this situation, no welcome mat meant keep out." *Grable*, 545 U.S. 318-19. While *Grable* went on to explain that the absence of a cause-of-action provision is not determinative, this certainly provides a starting point for this part of the analysis.

Under the prescribed standard, we must pursue this question further and inquire into the risk of upsetting the intended balance by opening the federal courts to an undesirable quantity of litigation. *See id.* at 315. This is, to be sure, a speculative inquiry, requiring us to speculate about the consequences for the federal caseload that will flow from this decision, and, although this is intended to be a *reasoned* speculation, we concede that reasonable people can — and

no doubt will — disagree over the likelihood or severity of the possible consequences.

While we ultimately conclude that the possibility of encumbering the federal courts with these tax-code-related cases appears both real and significant, or at least not insignificant, we are at pains to avoid overstating our position. We eschew predictions of any extreme outcome that may lurk in such phrases as "flood of litigation" or "overwhelm the federal courts," and we have not succumbed to some eschatological trembling. Rather, we posit an objective and reasoned — albeit necessarily speculative — view that, by allowing the present dispute over a relatively obscure provision of the tax code to be pursued in federal court, we would extend federal jurisdiction not only to the question raised in this case, but to any dispute over the meaning or effect of virtually any provision in the entire federal tax code.

The question is not whether such a holding will open the federal courts to analogous cases — under the most rudimentary concept of legal precedent it certainly will. The pressing questions are what cases would be analogous and how many would there be. This case involves (1) the interpretation of (2) the effective date provision of (3) a construction-expense accounting guideline (4) in the federal tax code. The universe of analogous cases would conservatively include any case that involves (1) the interpretation of (2) any provision that is at least as significant as the effective date provision of (3) any accounting guideline that is at least as significant as construction-industry interest-payment expenses that is (4) in the

federal tax code. It is no overstatement to say that this description covers numerous tax code provisions; it may not be an overstatement to say that it covers them all. Examples of such cases abound, including common malpractice actions against tax preparation professionals or company accountants involving disputed interpretations of tax code provisions; actions by shareholders for misstatement of earnings and profits; actions by employees for overstatement of earnings on W-2 forms or by independent contractors for overstated 1099 forms. Limitation of this universe of analogous cases would — we think — be unlikely.

Even recognizing that there are some limits, such as IRS preemption and statutes of limitation, we are left with the conclusion that finding a substantial federal question in the case we decide today would open the door of the federal courts to significantly more than the solitary case asserting a constitutional challenge, as in *Smith*, 255 U.S. at 214, or the "microscopic effect" portended by the quiet title action in *Grable*, 545 U.S. at 315. And even if the actual number of cases proved not to be overwhelming, or even uncomfortably burdensome, it appears unlikely that Congress — through its silence — intended to open the federal court door quite so wide.

VI.

The balance here weighs against the propriety of federal jurisdiction, and this case "cannot be squeezed into the slim category [of cases that] *Grable* exemplifies." *See Empire*, 126 S. Ct. at 2137. "The state court in which the [] suit was lodged is competent to apply federal law, to the extent it is relevant,

and would seem [suitably] positioned to determine" the application of § 312(n)(1) in the present case. *Id.* We therefore **REVERSE** and **REMAND** to the district court for dismissal for lack of federal subject-matter jurisdiction.

CONCURRING IN PART, DISSENTING IN PART

MARTHA CRAIG DAUGHTREY, Circuit Judge, concurring in part and dissenting in part. A majority of the court relies upon two bases for its decision today that federal courts may not exercise jurisdiction over the claims asserted by the plaintiffs in this case. First, the majority concludes "that 26 U.S.C. § 7422 does not preempt the present case." With that determination, I am in full agreement. Second, the majority states that there is no *substantial* federal interest in obtaining a federal court decision regarding the effective date of a provision of the federal Internal Revenue Code that will enhance the ability of a federal agency to collect the monies necessary to carry on the workings of the federal government. Even if the federal interest were held to be substantial, the majority nevertheless contends that we should remand this matter to the state court lest provision of a federal forum would portend an extension of federal jurisdiction that would embroil us in "any dispute over the meaning or effect of virtually any provision in the entire federal tax code," as well as in state malpractice actions, shareholder suits, and other decidedly non-federal disputes. *See* Maj. Op. at 15-16.

From these portions of the majority's ruling, I respectfully dissent.

Congress has seen fit to entrust federal district courts with original jurisdiction over "civil actions *arising under* the Constitution, laws, or treaties of the United States." 28 U.S.C. § 1331 (emphasis added). Because the non-diverse plaintiffs in this litigation allege that their suit raises claims based only upon the Ohio *state law* concepts of breach of contract and fraudulent misrepresentation, they argue that any exercise of federal jurisdiction in this matter would be unjustified. As recognized almost 25 years ago by the United States Supreme Court, however, "[e]ven though state law creates [a litigant's] causes of action, its case might still 'arise under' the laws of the United States if a well-pleaded complaint established that its right to relief under state law requires resolution of a substantial question of federal law in dispute between the parties." *Franchise Tax Bd. of Cal. v. Constr. Laborers Vacation Trust for S. Cal.*, 463 U.S. 1, 13 (1983).

Significantly, the Supreme Court has ruled just two years ago in *Grable & Sons Metal Products, Inc. v. Darue Engineering and Manufacturing*, 545 U. 308 (2005), another case from this circuit, that even a state-law action to quiet title can implicate "a substantial federal interest (in construing federal tax law)." *Id.* at 311. In that case, although Grable & Sons filed its complaint in state court against only Darue Engineering and Manufacturing, the entity then in possession of an Internal Revenue Service-issued quitclaim deed to the plaintiff's former prop-

erty, the Court recognized that the determinative issue involved an analysis of the validity of the notice provided to Grable & Sons by a government agency. Consequently, not only does "[t]he Government . . . [have] a direct interest in the availability of a federal forum to vindicate its own administrative action . . .," *id.* at 315, but "*the national interest in providing a federal forum for federal tax litigation is sufficiently substantial* to support the exercise of federal question jurisdiction over the disputed issue on removal, which would not distort any division of labor between the state and federal courts, provided or assumed by Congress." *Id.* at 310 (emphasis added).

As the majority concedes, even the Supreme Court's subsequent ruling in *Empire Healthchoice Assurance, Inc. v. McVeigh*, 126 S.Ct. 2121 (2006), has "not shut the jurisdictional door propped open in *Grable*." *See* Maj. Op. at 11. *Empire* involved a dispute concerning a federal employee's insurance carrier's attempt to obtain reimbursement from the insured after the estate of the federal employee recovered damages "(unaided by the carrier-administrator) in a state-court tort action against a third party alleged to have caused the accident." *Id.* at 2127. Concluding that such a quintessential state-law contribution claim does not raise a substantial federal question, even though a federal employee's recovery pursuant to a federal employees' insurance policy was at issue, the Court emphasized numerous differences in the *Grable* and the *Empire* scenarios. Foremost among those differences was the simple fact that *Grable* "centered on the action of a federal agency

(IRS) and its compatibility with a federal statute." *Empire*, 126 S.Ct. at 2137. The Court further explained that the federal question in *Grable* was substantial, that judicial resolution of the question would be dispositive of the case before it, as well as of future cases, and that the dispute involved a pure issue of law. *See id.*

Despite the Court's successful effort in *Empire* to distinguish the situation presented in that case from the scenario in *Grable*, the justices have also recognized that there is no "single, precise, all-embracing test for jurisdiction over federal issues embedded in state-law claims between nondiverse parties." *Grable*, 545 U.S. at 314 (internal quotation marks and citation omitted). "Instead, the question is, does a state-law claim necessarily raise a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities." *Id.*

In addressing that question in this action, the majority opinion first correctly concedes that a federal issue is indeed raised in the plaintiffs' complaint and that the federal issue "is actually disputed." *See* Maj. Op. at 11. Despite that concession, the majority asserts that the substance of the dispute is somehow minimized by the absence of participation by a federal agency, citing *Empire*'s recognition that *Grable* "centered on the action of a federal agency." *See* Maj. Op. at 13, citing *Empire*, 126 S.Ct. at 2137. Nowhere in *Grable* nor in *Empire*, however, did the Supreme Court indicate that agency participation in litigation

constituted a *sine qua non* to the exercise of federal jurisdiction. Rather, such participation was merely one *factor* in reaching the ultimate conclusion that "the national interest in providing a federal forum for federal tax litigation is sufficiently substantial." *Grable*, 545 U.S. at 310. In this case, however, even in the absence of participation by a federal agency, the federal interest in the interpretation of federal tax laws still remains not only substantial, but paramount.

Indeed, as recognized by the majority, "resolution of this issue will require the analysis and interpretation of federal law, specifically the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 61(e), 98 Stat. 494 (1984), and 26 U.S.C. § 312." *See* Maj. Op. at 13. Furthermore, although "the specific question at issue [might] concern[ ] only the interpretation of the effective date of an accounting provision," that interpretation "governs certain earnings-and-profits calculations." *See* Maj. Op. at 13. Thus, the pure issue of law in this case – the effective date of a statutory provision – affects directly "how much tax security-holders must pay," *Mikulski v. Centerior Energy Corp.*, 435 F.3d 666, 678 (6th Cir. 2006) (Daughtrey, J., concurring in part and dissenting in part), and it is the amount of that tax collected from citizens, corporate and individual, that determines the levels of funding available for health, safety, and public welfare concerns; for programs and institutions designed to safeguard private rights, civil rights, and the general public interest; and for the daily operation of government activities including warfare, homeland secu-

rity, and other aspects of national defense.

Perhaps the most disconcerting aspect of the majority's analysis of the "importance" of the question to be resolved in this case is its "subjective view . . . that this particular question is not particularly important to the federal government" because the IRS has not litigated a case involving the provision in the 22 years since its enactment. *See* Maj. Op. at 13. Clearly, such a lack of litigation bears no necessary correlation to the importance of the subject matter. As recognized by our sister circuit, for example, in the 216 years since the adoption of the Third Amendment to the United States Constitution, "[j]udicial interpretation of [that provision] is nearly nonexistent." *Custer County Action Ass'n v. Garvey*, 256 F.3d 1024, 1043 (10th Cir. 2001). The Third Amendment's prohibition on the quartering of soldiers in private residences without consent is, however, one of the constitutional bulwarks protecting privacy rights inherent in American citizenship. Especially in this time of seemingly unfettered governmental efforts to intrude into private realms, I would hope that the majority would not equate the "nearly nonexistent" litigation involving the Third Amendment with a lack of importance of the principles protected by that provision.

In its next effort to bolster its declaration that the issue presented in this litigation is not substantial, the majority claims that resolution of the inquiry into the propriety of Centerior's earnings and profits calculation is not necessarily dispositive of this case. *See* Maj. Op. at 13. As I noted in my partial dissent in the

original panel treatment of this case, however:

> [T]he question of Centerior's compliance with Section 312(n)(1) of the Code . . . is central to the plaintiffs' state law claim . . . [and] also supports the district court's exercise of federal jurisdiction. In their complaint, the plaintiffs charged that the defendants "failed to follow and apply the structure and conceptual framework of the tax laws, as set forth in the Internal Revenue Code and the regulations promulgated thereunder." They also answered an interrogatory intended to clarify their claims with the statement that "Centerior violated the Internal Revenue Code by doing what . . . the Code specifically forbids . . . ." Furthermore, at oral argument on the issue of federal jurisdiction before the district court, the attorney for the plaintiffs acknowledged that an analysis of the tax code is "critical" to the case and that a violation of the Code is not only the measure of damages but also the "underlying rationale for the fraud." The majority asserts that in analyzing the plaintiffs' claims, a federal court would "engage in only insubstantial analysis or interpretation of federal law," but this conclusion fails to recognize that determining whether the defendants complied with the Code is essential to a resolution of the plaintiffs' claims.

Id. at 677-78 (Daughtrey, J., concurring in part and dissenting in part).

Finally, the majority submits that a recognition of federal jurisdiction in this limited instance raises

"the possibility of encumbering the federal courts with these tax-code related cases." *See* Maj. Op. at 15. I continue to believe, however, that it is instead more likely than not "that the refund procedures in the Internal Revenue Code, in conjunction with state statute of limitations, would act as a reasonable limit on the number of cases that were actually heard in federal court." *Id.* at 678 (Daughtrey, J., concurring in part and dissenting in part). To the extent that they do not, we and our federal colleagues around the country will, I am convinced, continue to perform our sworn duties to judge those matters raising substantial federal questions, whatever they may turn out to be.

For these reasons, I concur in the majority's preemption analysis, but I respectfully dissent from the remainder of the majority opinion and would thus affirm the district court's denial of the plaintiffs' motion to remand this matter to state court. I am authorized to say that Judges Martin, Moore, Cole, and Clay join in this separate opinion.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

JEROME R. MIKULSKI; ELZETTA C. MIKULSKI,
On Behalf of Themselves
and All Others Similarly Situated,

Plaintiffs-Appellants,

v.

CENTERIOR ENERGY CORPORATION;
FIRST ENERGY CORPORATION;
CLEVELAND ELECTRIC ILLUMINATING COMPANY;
THE TOLEDO EDISON COMPANY,

Defendants-Appellees.

No. 03-4486

Appeal from the United States District Court
for the Northern District of Ohio at Cleveland.

Nos. 02-02440; 03-00191; 03-00192; 03-07043

Donald C. Nugent, District Judge.

Argued: February 4, 2005
Decided and Filed: January 26, 2006

Before: BATCHELDER and DAUGHTREY, Circuit Judges; O'KELLEY, District Judge.*

* The Honorable William C. O'Kelley, Senior United States District Judge for the Northern District of Georgia, sitting by designation.

OPINION

WILLIAM C. O'KELLEY, District Judge. This appeal arises from four state court actions against the defendants that were separately removed to the U.S. District Court for the Northern District of Ohio. The four cases were later consolidated to address the defendants' separately-filed motions for judgment on the pleadings after the court denied the separate motions to remand.

I. *Factual and Procedural History*

On January 22, 2002, plaintiffs Jerome R. Mikulski and Elzetta C. Mikulski filed an action (*Mikulski I*) against Centerior Energy Corporation ("Centerior") and First Energy Corporation (the successor company to Centerior) in Ohio's Cuyahoga County Court of Common Pleas. The plaintiffs sought to represent a class of individual shareholders in Centerior who claim that they received inaccurate Forms 1099-DIV or equivalent substitutes as information statements

from the company in 1986. The Mikulskis sought damages in the amount of what they claim to be overpaid federal and state taxes plus costs and attorneys' fees.

On October 30, 2002, the Court of Common Pleas directed the plaintiffs to clarify their calculation of the alleged error in the shareholder information statements. On November 15, 2002, in response to this order, the plaintiffs served First Energy with a copy of their supplemental response to the interrogatory. In the response, they disclosed that their claims for relief involved whether the defendants violated Section 312(n)(1) of the Internal Revenue Code.[2] The response stated, in part:

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[1] Pursuant to 26 U.S.C. § 6042(a)(1), the defendants were required to file an information return with the Internal Revenue Service reporting payments of dividends aggregating $10 or more made to any person during any calendar year. A company that furnishes an information return is required to give notice to the person who is the subject of the return by written statement under 26 U.S.C. § 6042(c) and is subject to a penalty, under certain conditions, for failure to comply with § 6042(a). The IRS may instruct a corporation to deduct and withhold a specified amount of tax for dividends if the payee underreports or if there is a payee certification failure.

[2] Under Internal Revenue Code ("IRC") § 316(a), distributions to a company's shareholders constitute taxable dividends to the extent the corporation has earnings and profits as defined by § 312 at the time of the distribution. Those distributions not paid from earnings and profits are returns of capital of the shareholders' basis in the stock; these are tax-free returns of capital when a corporation distributes more than its earnings and profits.

> From its formation in 1986, [Centerior] deliberately and fraudulently manipulated its tax accounting practices over a period of years in order to artificially inflate its "earnings and profits" (fn. "A defined term under the Internal Revenue Code...) so that it would look more profitable to its investors. This was vitally important to Centerior in 1986 because it needed to justify the recent merger of CEI and Toledo Edison. In the process, however, Centerior defrauded some 200,000 shareholders who lost more than $35 million from being wrongly instructed by Centerior to pay too much in federal income taxes on their 1986 distributions alone.
>
> Centerior violated the Internal Revenue Code by doing what Section 312(n)(1) of the Code specifically forbids – *Centerior illegally included* in its earnings and profits calculations for 1986 (and subsequent years) *more than $1.5 billion of construction expenses* that its subsidiaries had incurred in 1984 and earlier. Code Section 312(n)(1) states that no construction expenses incurred before January 1, 1985 may be considered in calculating a corporation's earnings and profits.

Pls.' Supplemental Resp. to Interrog. No. 1 of Defs.' Second Set of Interrogs. (Emphasis in original).

On December 13, 2002, the defendants removed the case to the United States District Court for the Northern District of Ohio pursuant to 28 U.S.C. § 1441(b). The defendants alleged that the plaintiffs' complaint raised a substantial federal question and

that resolution of that question was essential to the resolution of the plaintiffs' claims, based upon the plaintiffs' supplemental response to interrogatories.

The plaintiffs filed three additional state law actions on December 31, 2002. *Mikulski II*, *Mikulski III*, and *Mikulski IV* assert identical theories of liability but implicate different tax years and different operating entities: Centerior Energy, Cleveland Electric, and Toledo Edison, the latter two being separate operating companies that together formed Centerior in 1986. Within thirty days of the service of the complaints in these three subsequent suits, each action was removed to the federal district court by the defendants.

On January 12, 2003, the plaintiffs moved to have the case remanded to the Cuyahoga County Court of Common Pleas, which motion was denied on February 28, 2003. The district court found that the plaintiffs' causes of action, although structured as breach of contract and fraudulent misrepresentation claims, raised a substantial federal question involving federal tax law. The plaintiffs' two subsequent motions for reconsideration were also denied. Additionally, the district court denied the plaintiffs' motions to remand *Mikulski II*, *III*, and *IV*.

On March 19, 2003, the defendants filed a motion for judgment on the pleadings on the grounds that the plaintiffs' actions were preempted under federal law expressly by 26 U.S.C. § 7422 and implicitly by the scope and complexity of the Internal Revenue Code. The matter was referred to Magistrate Judge Patricia A. Hemann for consideration of pretrial mo-

tions. Following extensive briefing, the magistrate judge issued a report and recommendation on June 3, 2003, which concluded that judgment on the pleadings should be granted and, to the extent that there were no distinguishing facts in the companion cases, judgment would also be appropriate in these matters. In the report and recommendation, the magistrate judge noted that the plaintiffs could have raised the issue with the Internal Revenue Service, could have filed for a refund, or could have pursued administrative remedies. The magistrate judge also noted that if the court allowed the lawsuit to proceed, it could open the floodgates of litigation in federal court to suits by every shareholder for misstatement of earnings and profits, by every employee for overstatements of earnings on W-2 forms by employers, and by every independent contractor against a payor on an overstated 1099 form under a theory of breach of implied or express contract or fraudulent misrepresentation. The report and recommendation noted that the Internal Revenue Code was enacted to avoid these types of actions and to allow an injured taxpayer to proceed for a refund directly against the government.

After the magistrate judge's report and recommendation in *Mikulski I*, the defendants moved for judgment on the pleadings in the companion cases. Because this suit and the three others filed by the plaintiffs had factual similarities, the cases were consolidated by the district court for final briefing. The plaintiffs agreed that the report and recommendation could be considered as having been entered in all four cases.

The plaintiffs objected to the report and recommendation on the grounds that it mischaracterized the claim as one for a tax refund and therefore erroneously concluded that the claims are preempted by federal tax laws. The plaintiffs also filed a motion for reconsideration of the order denying remand. The district court held a hearing on September 25, 2003 on the plaintiffs' objections to the report and recommendation. At the hearing, the plaintiffs primarily relied upon the Supreme Court decision in *Beneficial National Bank v. Anderson*, 539 U.S. 1 (2003), stating that the Supreme Court stressed the need for complete preemption in removal cases. The plaintiffs alleged that there was no complete preemption, just mere presence of a federal statute in an action that seeks relief only under state law, so there was no basis for removal jurisdiction to the federal courts. They stressed that their suit was based on state law claims for breach of contract and fraud and not that the defendants allegedly violated the Internal Revenue Code, which was not relevant. The defendants responded that the magistrate judge and the district court reached the correct result in relying on proper grounds to support removal jurisdiction.

Following oral argument, on October 6, 2003, the district court considered and rejected the plaintiffs' arguments for remand and adopted the magistrate judge's report and recommendation. Judge Donald C. Nugent stated that, construing the complaint in the light most favorable to the plaintiffs and accepting all of the complaint's factual allegations as true, he found the defendants were entitled to judgment on

the pleadings. The district court also granted the defendants' motions for judgment on the pleadings in the three companion cases. The plaintiffs then filed this appeal.

II. *Standard of Review*

This court reviews a district court's decision of whether to dismiss for lack of federal subject matter jurisdiction *de novo*. *Dixon v. Ashcroft*, 392 F.3d 212, 216 (6th Cir. 2004) (citing *Joelson v. United States*, 86 F.3d 1413, 1416 (6th Cir. 1996)). The factual findings made by the district court in deciding a motion to dismiss, however, are reviewed only for clear error. *Dixon*, 392 F.3d at 216 (citing *Jones v. City of Lakeland*, 175 F.3d 410, 413 (6th Cir. 1999) (abrogated on other grounds) (quoting *Gafford v. Gen. Elec. Co.*, 997 F.2d 150, 161 (6th Cir. 1993))). The court reviews the district court's refusal to remand a case removed from state court *de novo*. *Harper v. AutoAlliance Int'l, Inc.*, 392 F.3d 195, 200 (6th Cir. 2004) (citing *Long v. Bando Mfg. of Am., Inc.*, 201 F.3d 754, 759 (6th Cir. 2000), and *Her Majesty the Queen in Right of the Province of Ontario v. City of Detroit*, 874 F.2d 332, 338 (6th Cir. 1989)).

III. *Analysis*

In their briefs, the parties have outlined numerous issues addressing the motion to remand and the motion for judgment on the pleadings. This opinion will address only the former question: whether the district court erred in denying the plaintiffs' motions to remand, or, stated another way, whether the federal courts have jurisdiction over these lawsuits.

The district court premised its denial of the plaintiffs' motions to remand on the statement that the complaint relies upon the interpretation of the Federal Tax Code and Federal Tax Regulations and therefore raised a substantial question of federal law. The court found that the plaintiffs' suit was one for a tax refund and therefore must be pursued under 26 U.S.C. § 7422, which requires that a refund or credit be sought from the IRS before bringing suit against the defendants. The magistrate judge found particularly relevant the fact that, if a question of tax law were decided in state court, the federal government would not be bound by a judgment against the defendants. The magistrate judge's report and recommendation, approved and adopted by the district court, also raises the artful pleading doctrine.

A. *Artful Pleading and Preemption*

In the absence of diversity, a civil action filed in state court may be removed to federal court only if the claim "arises under" federal law. *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 6 (2003) (citing 28 U.S.C. § 1441(b)). Whether the claim arises under federal law must be determined by applying the "well-pleaded complaint" rule. *Caterpillar, Inc. v. Williams*, 482 U.S. 386, 392 (1987) (citing *Gully v. First Nat'l Bank*, 299 U.S. 109, 112-13 (1936)); *Heydon v. MediaOne of Southeast Mich., Inc.*, 327 F.3d 466, 469 (6th Cir. 2003) (citing *Merrell Dow Pharm., Inc. v. Thompson*, 478 U.S. 804, 808 (1986) and *Musson Theatrical, Inc. v. Fed. Express Corp.*, 89 F.3d 1244, 1252 (6th Cir. 1996)). A claim arises under federal law for jurisdictional purposes only if the plaintiff's

statement of the cause of action on the face of its properly pleaded complaint affirmatively shows that it is based on federal law. *Beneficial Nat'l Bank*, 539 U.S. at 6-8; *Caterpillar*, 482 U.S. at 392. The presence of a federal defense to a state law claim, even one relying on the preemptive effect of a federal statute, is insufficient to confer federal jurisdiction and will not provide a basis for removal. *Beneficial Nat'l Bank*, 539 U.S. at 6 (citing *Louisville & Nashville R.R. Co. v. Mottley*, 211 U.S. 149, 152 (1908) and *Taylor v. Anderson*, 234 U.S. 74 (1914)); *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58, 63 (1987); *Franchise Tax Bd. of Calif. v. Constr. Laborers Vacation Trust for S. Calif.*, 463 U.S. 1, 9-12 (1983); *Musson Theatrical*, 89 F.3d at 1252.

The exception to this is the "artful pleading" exception to the well pleaded complaint rule. Under the artful pleading exception, when a plaintiff has carefully drafted the complaint to avoid naming a federal statute as a basis for federal jurisdiction, but the complaint is nonetheless based on such statute, the federal court will have jurisdiction.

In this case, the defendants have not shown that the plaintiffs seek relief under any federal statute but, instead, raise the artful pleading exception in their brief, arguing that the plaintiffs structured their complaint to avoid federal jurisdiction but that such jurisdiction would be appropriate because the case is based on federal tax law. The magistrate judge and the district court rely heavily upon airline passenger excise tax cases to preempt the plaintiffs' state law claims through 26 U.S.C. § 7422. *See Bren-*

nan v. Southwest Airlines Co., 134 F.3d 1405, 1409, *amended without substantive change*, 140 F.3d 849 (9th Cir. 1998) (in collecting excise tax from passengers, airlines act as agents for the IRS); *Sigmon v. Southwest Airlines Co.*, 110 F.3d 1200, 1203 (5th Cir.), *cert. denied*, 522 U.S. 950 (1997) (citing 26 U.S.C. § 4291 and *Kaucky v. Southwest Airlines Co.*, 109 F.3d 349 (7th Cir. 1997) (airlines act as government agents in collecting airline ticket excise taxes)); *Kaucky*, 109 F.3d at 351-52 (7th Cir.), *cert. denied*, 522 U.S. 949 (1997) (where Congress makes a private entity like an airline a collection agent for the IRS, the airline is treated as an employee of the IRS for § 7422 purposes). This reliance is misplaced.

In the airline cases, the preemption decisions were based on the court's finding that the defendant airline was acting as a collection agent of excise taxes for the Internal Revenue Service. No such finding has been made about the defendants in this case. Other courts, including district courts, recognize that the airline excise tax cases have limited applicability beyond their unique set of circumstances. *See In re Air Transp. Excise Tax Litig.*, 37 F. Supp. 2d 1133, 1137 (D. Minn. 1999) (distinguishing airline cases; refusing to preempt plaintiffs' claims for improper collection of excise taxes on air freight of Federal Express because elements of "true" tax refund claim not present).

The plaintiffs' state law claims do not fall within the express language of 26 U.S.C. § 7422, which would prevent recovery for failure to file a claim against the United States with the Internal Revenue

Service. The plaintiffs' complaints center on the alleged inflation of the defendants' earnings and profits in violation of the Internal Revenue Code's § 312(n)(1), the over-reporting of taxable dividends to the plaintiffs and other taxpaying shareholders, and, as a result, the inducement of the plaintiffs and other shareholders to overpay their respective federal and state income taxes. Section 7422 does not apply to these complaints by its plain language; the plaintiffs do not complain of erroneous or illegal tax assessments or collections by the defendants.

The district court erred in adopting the report and recommendation's conclusion that, because the plaintiffs' damages are calculated in terms of overpaid income taxes, the plaintiffs' state law claims constitute federal income tax refund claims. When the plaintiffs filed their lawsuit in 2002, they could not file a claim against the United States for a refund for their 1986 taxes paid. The Internal Revenue Code limits refunds to the later of three years after the tax return was filed or two years after the tax was paid. 26 U.S.C. § 6511.

Not all claims that seek damages against the United States for overpayment of taxes are claims for the recovery of tax refunds, even though damages are measured in taxes. This court has often stated that the nature of a plaintiff's state law claims is not determined by the nature of his underlying damages. For instance, references to retirement plan benefits or assets are insufficient to convert a plaintiff's state law claims into federal ERISA claims for preemption purposes; the "reference to plan benefits was only a

way to articulate specific, ascertainable damages." *Marks v. Newcourt Credit Group, Inc.*, 342 F.3d 444, 453 (6th Cir. 2003) (citing *Wright v. Gen. Motors Corp.*, 262 F.2d 610, 615 (6th Cir. 2001)); *see also Husvar v. Rapoport*, 337 F.3d 603, 609 (6th Cir. 2003); *Cyprus Amax Coal Co. v. United States*, 205 F.3d 1369, 1376 (Fed. Cir. 2000); *Brown v. United States*, 105 F.3d 621, 623 (Fed. Cir. 1997). The Supreme Court has found complete preemption in only three classes of cases: Section 301 of the Labor Management Relations Act of 1947 (LMRA), 29 U.S.C. § 185; the Employee Retirement Income Security Act of 1975 (ERISA), 29 U.S.C. §§ 1001 *et seq.*; and the National Bank Act, 12 U.S.C. §§ 38 *et seq. Beneficial Nat'l Bank*, 539 U.S. at 7-9.

The Supreme Court has explained that it found complete preemption under the LMRA and ERISA because "the federal statutes at issue provided the exclusive cause of action for the claim asserted and also set forth procedures and remedies governing that cause of action." *Id.* at 7-8. The Court found preemption under the National Bank Act because Congress intended the federal cause of action to be the exclusive remedy, not because the Act merely created a federal cause of action. *Id.* at 9 n.5. The Court has not yet recognized complete preemption for damage claims caused by allegedly inaccurate tax reporting by corporations to their taxpaying shareholders, especially when the claim involves both federal and state income taxes. This court ruled likewise when it found that ERISA did not preempt a state tax refund claim. *Thiokol Corp. v. Roberts*, 76 F.3d 751 (6th Cir.

1996).

Courts must take care to avoid creating complete preemption beyond the three areas of law recognized by the Supreme Court. *See, e.g., N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654 (1995). This circuit has recognized that complete preemption is a narrow rule for determining federal jurisdiction and has held that the National Flood Insurance Act, 42 U.S.C. § 4072, completely preempts state law because it explicitly confers "original exclusive jurisdiction" on the federal district courts. *Gibson v. Am. Bankers Ins. Co.*, 289 F.3d 943, 947 (6th Cir. 2002). It has declined, however, to extend complete preemption to statutes that lack similar language. *See Wellons v. Northwest Airlines, Inc.*, 165 F.3d 493 (6th Cir. 1999) (Airline Deregulation Act does not preempt state law race discrimination claim against airline); *Musson Theatrical*, 89 F.3d at 1253 (Airline Deregulation Act does not preempt state law fraud and misrepresentation claims against air freight carrier); *Strong v. Telectronics Pacing Sys., Inc.*, 78 F.3d 256 (6th Cir. 1996) (Medical Device Amendments to Federal Food, Drug, and Cosmetic Act do not preempt state law negligence claims against pacemaker manufacturer); *Gustafson v. City of Lake Angelus*, 76 F.3d 778 (6th Cir. 1996) (Federal Aviation Act does not preempt city ordinance prohibiting seaplanes from operating on city lake).

The United States District Court for the Northern District of Ohio seems to be the first court in the country to find complete preemption in the Internal

Revenue Code. If the district court were correct, it would federalize most state law claims that remotely address tax issues, such as suing one's accountant or tax preparer.

There is no reason for this court to conclude that Congress intended to create an exclusive federal remedy under the Internal Revenue Code for miscalculation of earnings and profits and misreporting of taxable dividends. As the Supreme Court has recognized, Congress knows how to enact exclusive private rights of action and expressly impose liability for private misconduct in the Internal Revenue Code in other areas, such as Section 6701. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176-77, 182-83 (1994). Congress has expressly provided non-exclusive federal private causes of action for violation of several sections of the

[3]In July 1996, Congress enacted 26 U.S.C. § 7434, which expressly creates a private right of action in favor of any taxpayer who is injured because another person or entity has willfully filed a fraudulent information return asserting that payments have been made to a taxpayer. All events giving rise to plaintiffs' cases preceded the enactment of Section 7434. Its enactment by Congress, however, is indicative of the fact that the legislative branch never intended for Section 7422 to create an implied right of action, much less to provide the exclusive remedy for fraudulent filing claims. Internal Revenue Code, including Sections 7426(a)(1), 7431(a)(2), 7432, and 7434. *See In re Hawkins*, 224 B.R. 334, 337 (Bankr. E.D. La. 1998) (§ 7426(a)(1) is not an exclusive remedy for a person suing over an IRS levy). Four specific provisions of the Code indicate that Congress in-

tended the private federal remedy to be exclusive: Sections 6110(j)(1)(B), 897(I)(4), 7433(a), and 7433(e). No such provisions for exclusive federal causes of action are set forth in Sections 312(n)(1) or 6042(c)). The language and legislative history of Section 7422 also indicate that Congress did not intend for the tax refund procedure to be the exclusive federal remedy for fraudulent dividend reporting causing shareholders to overpay their income taxes. *See* S. Rep. 89-1625, 89th Cong. 2d Sess. (1966), 1966 USCCAN 3676, 3681-82.[3] The intended purpose of Section 7422 was to protect government collection officers from being sued by taxpayers and to provide taxpayers with a means to obtain relief from improper collections by tax collectors. *Id.*

The plaintiffs did not artfully plead in their complaint to improperly avoid federal jurisdiction, nor are their claims completely preempted by federal law. For these reasons, this court finds that the district court erred in its decision that the plaintiffs' state law claims were federal tax claims preempted by 26 U.S.C. § 7422.

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[3] In July 1996, Congress enacted 26 U.S.C. § 7434, which expressly creates a private right of action in favor of any taxpayer who is injured because another person or entity has willfully filed a fraudulent information return asserting that payments have been made to a taxpayer. All events giving rise to plaintiffs' cases preceded the enactment of Section 7434. Its enactment by Congress, however, is indicative of the fact that the legislative branch never intended for Section 7422 to create an implied right of action, much less to provide the exclusive remedy for fraudulent filing claims.

B. *Substantial Federal Question*

The district court also based its finding of removal jurisdiction on the substantial federal question doctrine. The Supreme Court in *Franchise Tax Board v. Construction Laborers Vacation Trust*, 463 U.S. 1 (1983), created the "substantial federal question" exception to the well-pleaded complaint rule. *Franchise Tax Bd. of Calif. v. Constr. Laborers Vacation Trust for S. Calif.*, 463 U.S. 1. Before the Supreme Court decided *Beneficial National Bank v. Anderson*, 539 U.S. 1 (2003), some courts recognized two narrow exceptions to the well-pleaded complaint rule: the "substantial federal question" exception and the "complete preemption" exception. The defendants in this case originally based removal on the substantial federal question doctrine.

Under the substantial federal question doctrine, a state law cause of action actually arises under federal law, even though Congress has not provided a federal private right of action, "where the vindication of a right under state law necessarily turn[s] on some construction of federal law." *Franchise Tax Bd.*, 463 U.S. at 9 (citing *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180 (1921) and *Hopkins v. Walker*, 244 U.S. 486 (1917)). The mere presence of a federal issue in a state law cause of action, however, does not automatically confer federal question jurisdiction, either originally or on removal. In order to invoke the substantial federal question doctrine announced in *Franchise Tax Board*, this circuit held prior to the *Beneficial National Bank* decision that the federal question raised by the state law complaint must be:

1) substantial; 2) disputed; 3) of great federal interest; and 4) resolution of the federal question must be necessary to the resolution of the state law claim. *Long v. Bando Mfg. of Am., Inc.*, 201 F.3d 754, 757-59 (6th Cir. 2000). The nature of the federal interest is vitally important. "[E]ven when there is [a private] cause of action, the use of a federal statute as an element of a state cause of action may or may not raise a substantial federal question depending upon the nature of the federal interest at stake in the case." *Miller v. Norfolk & W. Ry. Co.*, 834 F.2d 556, 562 (6th Cir. 1987) (citing *Merrell Dow Pharm., Inc. v. Thompson*, 478 U.S. 804, 814 n.12 (1986)).

The Supreme Court first eroded the substantial federal question doctrine in its *Merrell Dow* decision. *Merrell Dow Pharm.*, 478 U.S. 804. In *Merrell Dow*, the Court held that federal question jurisdiction was not warranted in a state law negligence claim in which the plaintiff argued that the defendant was negligent under state law for misbranding a drug in violation of federal law. A substantial factor in the holding in *Merrell Dow* is the absence of a private federal cause of action for the violation of the federal law involved. In these circumstances, the violation of a federal statute, pleaded as an element of a state law cause of action, does not state a claim arising under federal law. "The mere presence of a federal issue in a state cause of action does not automatically confer federal-question jurisdiction." *Id.* at 813. The Court implied that the congressional determination not to provide a private federal remedy for violation of a federal statute is "tantamount to a congressional

conclusion that the presence of a claimed violation of the statute as an element of a state cause of action is insufficiently 'substantial' to confer federal question jurisdiction." *Id.* at 814.

Merrell Dow, however, left uncertain whether the absence of a federal private cause of action precluded federal question jurisdiction.[4] The Supreme Court, in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, __ U.S. __, 125 S.Ct. 2363 (2005), provided clarification regarding the requirement of a federal private right of action for federal question jurisdiction. In *Grable & Sons*, the Court stated that *Merrell Dow* "should be read in its entirety as treating the absence of a federal private right of action as evidence relevant to, but not dispositive of, the 'sensitive judgments about congressional intent' that § 1331 requires." 125 S.Ct. at 2368 (internal citation omitted). The Court ruled that federal question jurisdiction existed in a quiet title action

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[4] The uncertainty regarding the private right of action requirement has resulted in some inconsistency within this court. In *Long*, the court noted that the Supreme Court's holding in *Merrell Dow* was unclear but read it as having "left open the possibility of federal jurisdiction even in the absence of an express or implied federal cause of action, if a substantial federal question of great federal interest is raised by a complaint framed in terms of state law, and if resolution of that federal question is necessary to the resolution of the state-law claim." 201 F.3d at 759. In *Heydon v. MediaOne*, 327 F.3d 466 (6th Cir. 2003), however, the court found that federal question jurisdiction did not exist where the plaintiffs' claim was a state law claim for trespass and the federal law upon which they attempted to predicate jurisdiction did not provide a private right of action.

where the title claim depended on the resolution of whether the taxpayer was given adequate notice, as defined by federal law. *Id.* The meaning of that notice provision, according to the Court, was "an essential element of [the plaintiff's] quiet title claim, and . . . it appears to be the only legal or factual issue contested in the case." *Id.*[5] The Court also noted the strong interest of the federal government in the collection of delinquent taxes and the rarity of state title questions that would raise contested matters of federal law. *Id.* Clear in this case is that the key point under the analytical framework is the nature of the federal interest at issue.

The substantial federal question doctrine does not provide the federal courts with jurisdiction in this case. As this court held in *Long* and *Miller*, the federal question raised by the state law complaint must be substantial, and the mere presence of a federal statute as an element of the complaint does not necessarily confer jurisdiction under the doctrine. *Long*, 201 F.3d at 757-59; *Miller*, 834 F.2d at 562. Although the amended complaints and the responses to interrogatories mention federal tax law, the true issues in this case are breach of contract and fraudulent mis-

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[5] Some courts have found that the Supreme Court removed doubt about the elimination of the substantial federal question doctrine as a basis for removal jurisdiction in *Beneficial National Bank*. The Court held that, absent diversity, there are only two ways a state claim can be removed to federal court: where Congress expressly provides or where complete preemption is present. *Beneficial Nat'l Bank*, 539 U.S. at 8. In *Grable & Sons*, however, the Supreme Court reinforced the viability of the substantial federal question doctrine.

representation with damages measured in the amount of federal and state income taxes overpaid by the plaintiffs because of the allegedly false information provided to them. If a court were to analyze the merits of the case, it would engage in only insubstantial analysis or interpretation of federal law. The true questions at issue in the case involve fraud and misreporting to shareholders, both of which claims are governed by state statutes. For this reason, federal courts do not have jurisdiction over the case under the substantial federal question doctrine. While this court finds that these cases should have been remanded to the state court, we do not express any opinion on the merits of the claims under the laws of Ohio.

IV. *Conclusion*

This court finds that the federal district court lacked jurisdiction over the cases and erred in denying the plaintiffs' motions to remand. Such a decision pretermits discussion of the merits of the case. For this reason, the district court's decision is hereby REVERSED and REMANDED for action not inconsistent with this opinion.

CONCURRING IN PART, DISSENTING IN PART

MARTHA CRAIG DAUGHTREY, Circuit Judge, *concurring in part and dissenting in part.*

Although I agree with the majority's determination that the plaintiffs' state law claims are not pre-

empted by § 7422 of the Internal Revenue Code, I disagree with the majority's conclusion that this case fails to present a substantial question of federal law sufficient to establish jurisdiction in federal court.

The majority correctly points out that the plaintiffs' claims turn on Centerior's failure to comply with § 312(n)(1) of the Code and do not fall within the language of the refund provision of § 7422. It is also evident that the plaintiffs are not suing to recover a tax or sum improperly collected; they are suing for tortious conduct, the damages for which may be measured by the amount of their overpayment of taxes. The plaintiffs' alleged overpayment to the IRS establishes a baseline for measuring their damages, but that amount may or may not represent the actual damage from the injuries alleged.

Section 7422 protects private entities that act as federal collection agents from returning an ir properly collected tax out of their own coffers. However, defendant Centerior, unlike the defendant in *Brennan v. Southwest Airlines Co.*, 140 F.3d 849 (9th Cir. 1998), on which the magistrate and district court judge relied, did not collect the alleged overpayment. Therefore, the defendant here does not face the prospect of having to refund monies it paid to the IRS without any recourse, as was the case with Southwest Airlines, which had remitted the sums it collected to the IRS. Centerior merely reported payouts to shareholders that were the basis for taxes paid directly to the IRS by those shareholders.

Sixth Circuit precedent recognizes that federal jurisdiction is a "possibility . . . even in the absence of

an express or implied federal cause of action, if a substantial federal question of great federal interest is raised by a complaint framed in terms of state law, and if resolution of that federal question is necessary to the resolution of the state-law claim." *Long v. Bando Mfg. of Am., Inc.*, 201 F.3d 754, 759 (6th Cir. 2000). That would certainly appear to be the case here, especially in light of the Supreme Court's recent opinion in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, __ U.S. __, 125 S.Ct. 2363 (2005). There, the Court ruled that a state court action to quiet title raising the question of the meaning of the notice provision of the Internal Revenue Code for a seizure of property by the Internal Revenue Service warranted the exercise of federal jurisdiction. Specifically, it held that "[*t*]*he meaning of the federal tax provision* is an important issue of federal law that sensibly belongs in a federal court" because the government "has a strong interest in the prompt and certain collection of delinquent taxes, and the ability of the IRS to satisfy its claims from the property of delinquents requires clear terms of notice to allow buyers . . . to satisfy themselves that the Service has touched the bases necessary for good title." *Id.* at 2368 (internal quotes omitted) (emphasis added). The *Grable* Court also noted both the relative rarity of such quiet-title actions and the likelihood that finding federal jurisdiction would "portend only a microscopic effect" on the allocation of the caseload between federal and state courts. *Id.*

Under *Grable*'s reasoning, the question of Centerior's compliance with Section 312(n)(1) of the Code,

which is central to the plaintiffs' state law claim, also supports the district court's exercise of federal jurisdiction. In their complaint, the plaintiffs charged that the defendants "failed to follow and apply the structure and conceptual framework of the tax laws, as set forth in the Internal Revenue Code and the regulations promulgated thereunder." They also answered an interrogatory intended to clarify their claims with the statement that "Centerior violated the Internal Revenue Code by doing what . . . the Code specifically forbids . . . ." Furthermore, at oral argument on the issue of federal jurisdiction before the district court, the attorney for the plaintiffs acknowledged that an analysis of the tax code is "critical" to the case and that a violation of the Code is not only the measure of damages but also the "underlying rationale for the fraud." The majority asserts that in analyzing the plaintiffs' claims, a federal court would "engage in only insubstantial analysis or interpretation of federal law," but this conclusion fails to recognize that determining whether the defendants complied with the Code is essential to a resolution of the plaintiffs' claims. The federal government's interest in the construction of a statute that controls how much tax security-holders must pay is surely as great as its interest in being able to collect delinquent taxes by seizing and selling properties.

It could be argued, of course, that a decision finding jurisdiction in this case might invite a flood of tax-refund suits masquerading as breach-of-contract claims in the federal courts – this case, after all, is based on IRS filings as far back as 1986. However, it

is likely that the refund procedures in the Internal Revenue Code, in conjunction with state statutes of limitation, would act as a reasonable limit on the number of cases that were actually heard in federal court.

For these reasons, I concur in the majority's holding that the plaintiffs' state law claims are not preempted by federal law but dissent from the remainder of the opinion. I would affirm the district court's decision to deny the plaintiffs' motion to remand to state court, reverse the judgment dismissing the complaint on the merits, and remand the case to the district court for further proceedings.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

JEROME R. MIKULSKI, et al.,

Plaintiffs.

v.

CENTERIOR ENERGY CORP., et al.,

Defendants.

CASE NO. 1:02 CV 2440

JUDGE DONALD C. NUGENT

Magistrate Judge Patricia A. Hemann

MEMORANDUM OPINION

This matter is before the Court upon the Report and Recommendation of Magistrate Judge Patricia A. Hemann recommending that the Court grant the Motion of Defendant FirstEnergy Corp. ("FirstEnergy") for Judgment on the Pleadings.[1] As set forth below, the Report and Recommendation (Document #34) is ADOPTED by this Court.

Factual and Procedural Background

On January 22, 2002, Plaintiffs Jerome R. and Elzetta C. Mikulski filed an action against Centerior Energy Corp. and FirstEnergy Corp. (collectively "First Energy" or "Defendant")[2] in the Cuyahoga County Court of Common Pleas. On January 25, 2002, Plaintiffs filed a First Amended Complaint. Subsequently, Defendants removed the case to this Court pursuant to 26 U.S.C. § 1441(b), on the basis that Plaintiffs' Complaint raises a substantial federal question and that resolution of the federal question is essential to the resolution of Plaintiffs' claims. Specifically, Plaintiffs' Supplemental Response to Interrogatory No. 1 of Defendant's Second Set of Interrogatories ("Supplemental Response") states that their claims for relief turn on whether FirstEnergy

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[1] Based upon the Joint Motion to Consolidate cases filed by the Parties, this case was consolidated with Case Nos. 1:03CV191, 1:03CV192 and 3:03CV7043.

[2] FirstEnergy Corp. is the successor to Centerior Energy Corp.

violated Section 312(n)(1) of the Internal Revenue Code.

On January 12, 2003, Plaintiffs first moved to have this case remanded to the Cuyahoga County Court of Common Pleas. On February 28, 2003, this Court denied Plaintiffs' Motion to Remand, finding that Plaintiffs' causes of action, although plead in state court as breach of contract and fraudulent misrepresentation claims, raised a substantial question of Federal tax law.[3]

As noted by the Magistrate Judge, the issue presented by the First Amended Complaint is whether Defendant's accounting practices with respect to taxable "dividends" versus nontaxable "returns of capital" resulted in Plaintiffs' overpayment of Federal income taxes. According to Plaintiffs, if Defendant had correctly calculated its earnings and profits, "all but a small fraction of the 1986 distributions to shareholders would have been non-taxable returns of capital instead of taxable dividends." Plaintiffs articulate their compensatory damages as the "amount of such overpayment" in federal income tax.

FirstEnergy argues the Plaintiffs' claim is one for a tax refund and is therefore preempted by Federal tax law. Alternatively, FirstEnergy argues that the claim is preempted by the Internal Revenue Code provisions establishing investigatory and enforcement mechanisms and a limited private right of ac-

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[3] Motions to Remand were filed by Plaintiffs in related Case Nos. 1:03CV191, 1:03CV192 and 3:03CV7043, prior to the Cases being consolidated, and were also overruled.

tion as to claims based on the willful filing of fraudulent information statements. Plaintiffs contend that this is not a tax refund claim, but rather an action to collect damages from Defendant for failing to accurately report to the shareholders all information concerning shareholder distributions. The failure to make such truthful disclosure, Plaintiffs contend, is a breach of fiduciary duty arising between the company and its shareholders through the share certificates and further gives rise to liability as a fraudulent misrepresentation. Thus, Plaintiffs contend their action is not preempted because the Internal Revenue Service does not provide for a private right of action against a corporation which has caused damage to its shareholders by mischaracterizing dividend income.

On March 19, 2003, Defendant filed a Motion for Judgment on the Pleadings, arguing that Plaintiffs' claims should be dismissed as being preempted by Federal tax law. Plaintiffs filed their Brief in Opposition on April 25, 2003, to which Defendant replied on May 19, 2003. On June 3, 2003, Magistrate Judge Hemann issued her Report and Recommendation, recommending that Defendant's Motion for Judgment on the Pleadings be granted. In her Report and Recommendation, the Magistrate Judge noted that Plaintiffs could have raised this issue with the Internal Revenue Service, could have filed for a refund, and could have pursued administrative remedies. Further, the Magistrate Judge stated that to allow this suit to proceed would open the Federal courts to every complaint by every shareholder for misstatement of earning and profits, every employee for over-

statement of earnings on his or her W2 by an employer, and every action by an independent contractor against a payor on an overstated 1099 under a theory of implied or express contract or fraudulent misrepresentation. As noted by the Magistrate Judge, the Internal Revenue Code was enacted to avoid such actions and to permit an injured taxpayer to proceed directly against the Government for a refund.

Plaintiffs filed their Objections to the Report and Recommendation of the Magistrate Judge on June 17, 2003, arguing that Magistrate Judge's Report and Recommendation "mischaracterizes this case as a tax refund claim and erroneously concludes the Plaintiffs' claims are preempted by the federal tax laws." On August 12, 2003, after the related cases were consolidated, Plaintiffs again filed Objections to the Report and Recommendation. On that same day, Plaintiffs also filed a Motion for Reconsideration of the Order denying Plaintiffs' Motion to Remand. On September 9, 2003, Defendant filed its Memorandum in Opposition to Plaintiffs' Motion for Reconsideration of the Court's Denial of their Motions to Remand, and responded to Plaintiffs' Objections to the Magistrate Judge's Report and Recommendation. A Reply Brief was filed on September 18, 2003.

A hearing was held in this Court on September 25, 2003 relative to Plaintiffs' Objections to the Report and Recommendation of the Magistrate Judge. At hearing, Plaintiffs relied upon, as they had in their written Objections, the decision of the United States Supreme Court in *Beneficial National Bank v. Ander-*

son, 123 S. Ct. 2058 (2003), relative to the doctrine of "complete preemption" stating that "the Court in *Anderson* ruled that the mere presence of a federal statute in an action that seeks relief only under state law, even one that 'preempts' state law, will not provide a basis for removal." Plaintiffs argued that there was no complete preemption, and therefore no basis for removal jurisdiction in this Court. Further, Plaintiffs argued that the fact that Defendants' allegedly violated the Internal Revenue Code was not relevant and that their claim was a state law claim for breach of contract and fraud. Defendants argued that the Magistrate Judge and this Court reached the correct result and relied upon the correct grounds to support removal jurisdiction.

Standard of Review for a Magistrate Judge's Report and Recommendation

The applicable district court standard of review for a magistrate judge's report and recommendation depends upon whether objections were made to the report. When objections are made to a report and recommendation of a magistrate judge, the district court reviews the case *de novo*. FED. R. CIV. P. 72(b) provides:

> The district judge to whom the case is assigned shall make a de novo determination upon the record, or after additional evidence, of any portion of the magistrate judge's disposition to which specific written objection has been made in accordance with this rule. The district

> judge may accept, reject, or modify the recommended decision, receive further evidence, or recommit the matter to the magistrate judge with instructions.

This Court has reviewed the Report and Recommendation of the Magistrate Judge *de novo*, in conjunction with the written objections and responses of the Parties, as well as the statements made at the hearing in this matter, and finds the Report and Recommendation to be well-reasoned and correct. First, Plaintiffs' Complaint, while attempting to create a state law cause of action, clearly requires the construction and interpretation of the Internal Revenue Code, relevant Regulations, and Federal law for resolution of Plaintiffs' claims. Second, Federal law in this case completely preempts Plaintiffs' State law causes of action. Finally, *Anderson*, 123 S. Ct. 2058, and its progeny reaffirm the correctness of the denial of remand and the finding of Federal jurisdiction in this case.

Based on the foregoing, the Court agrees with, and adopts, the findings and conclusions of Magistrate Judge Hemann as its own. Construing the Complaint in the light most favorable to Plaintiffs, and accepting all of the Complaint's factual allegations as true, Defendant is entitled to judgment on the pleadings. The Court hereby ADOPTS the Report and Recommendation of Magistrate Judge (Document #34). Accordingly, for the reasons stated in the Report and Recommendation, the Motion for Judgment on the Pleadings filed by Defendants (Document #24) is

GRANTED.

IT IS SO ORDERED.

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DONALD C. NUGENT

United States District Judge

DATED: _____

APPENDIX D

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO EASTERN DIVISION

JEROME R. MIKULSKI, et al.,

Plaintiffs.

v.

CENTERIOR ENERGY CORP., et al.,

Defendants.

CASE NO. 1:02 CV 2440

JUDGE DONALD C. NUGENT

Magistrate Judge Patricia A. Hemann

REPORT AND RECOMMENDATION

This case, along with Case Nos. 1:03CV191, 1:03CV192 and 3:03CV7043 (the "Related Cases"), has been referred to the magistrate judge for pretrial management, including the issuance of a Report and Recommendation on dispositive motions. Pending in the captioned case is the Motion of Defendant FirstEnergy Corp. for Judgment on the Pleadings.[1] The motion is opposed. For the reasons set forth below, the magistrate judge recommends that the motion be granted.

I.

On January 22, 2002 plaintiffs, Jerome R. and Elzetta C. Mikulski, filed an action against Centerior Energy Corp. ("Centerior") and FirstEnergy Corp. ("FirstEnergy") in the Cuyahoga County Court of Common Pleas (collectively "FirstEnergy" or "defendant").[2] On January 25, 2002 plaintiffs filed a First Amended Complaint. After plaintiffs' filed a copy of Plaintiffs' Supplemental Response to Interrogatory No. 1 to Defendant's Second Set of Interrogatories ("plaintiffs' supplemental response") in the state court action, FirstEnergy removed the case to this

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[1] FirstEnergy requested oral argument on the motion. The court finds that the briefs of the parties fully explain the law and their positions and thus determines that oral argument is not necessary.

[2] FirstEnergy is the successor to Centerior and hence is defending this action. Centerior was not a cognizable legal entity at the time the complaint was filed.

court.[3] Plaintiffs subsequently moved to have the case remanded; Judge Nugent overruled the motion to remand as well as plaintiffs' motion for reconsideration.[4] Based on defendant's brief, the court noted that plaintiffs' causes of action, although plead in state court as breach of contract and fraudulent misrepresentation, raised a substantial question of federal tax law. This court assumes that the federal question arises from the following portion of plaintiffs' supplemental response:

> From its formation in 1986, [Centerior] deliberately and fraudulently manipulated its tax accounting practices over a period of years in order to artificially inflate its "earnings and profits" (fn. "A defined term under the Internal Revenue code . . .) So that it would look more profitable to its investors. . . . In the process, however, Centerior defrauded some 200,000 shareholders who lost more than $35 million from being wrongly instructed by Centerior to pay too much in federal income taxes on their 1986 distributions alone.
>
> Centerior violated the Internal Revenue Code by doing what Section 312(n)(l) of the Code specifically forbids – ***Cente-***

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[3] Defendants in each of the Related Cases similarly removed the cases to federal court, where the cases were consolidated with the captioned one.

[4] Motions to remand the Related Cases were filed and also overruled.

> ***rior illegally included*** in its earnings and profits calculations for 1986 (and subsequent years) ***more than $1.5 billion of construction expenses*** that its subsidiaries had incurred in 1984 and earlier. Code Section 312(n)(l) states that no construction expenses incurred before January 1, 1985 may be considered in calculating a corporation's earnings and profits.

(Emphasis in original). Thus the issue presented by the first amended complaint is whether defendant's accounting practices with respect to taxable "dividends" versus nontaxable "returns of capital" resulted in plaintiffs' overpayment of federal income taxes. According to plaintiffs, if defendant had correctly calculated its earnings and profits, "all but a small fraction of the 1986 distributions to shareholders would have been non-taxable returns of capital instead of taxable dividends." Plaintiffs articulate their compensatory damages as the "amount of such overpayment" in federal income tax.

FirstEnergy argues that plaintiffs' claim in one for tax refund and hence is preempted by federal tax law. Alternatively FirstEnergy argues that the claim is preempted by Internal Revenue Code ("IRC") provisions establishing investigatory and enforcement mechanisms and a limited private right of action as to claims based on the willful filing of fraudulent information statements.

Plaintiffs contend that this is not a tax refund

claim but rather an action to collect damages from defendant for failing to accurately report to the shareholders all information concerning shareholder distributions. The failure to make such truthful disclosure, plaintiffs contend, is a breach of fiduciary duty[5] arising between the company and its shareholders through the share certificates and further gives rise to liability as a fraudulent misrepresentation. Thus, plaintiffs contend, their action is not preempted because the Internal Revenue Service ("IRS") does not provide for a private right of action against a corporation which has caused damage to its shareholders by mischaracterizing dividend income.

II.

A party may move for judgment on the pleadings pursuant to Fed. R. Civ. Pro. 12(c) once the pleadings are closed. The court "must construe the complaint in the light most favorable to the plaintiff, accept all of the complaint's factual allegations as true, and determine whether the plaintiff undoubtedly can prove no set of facts in support of his claim that would entitle him to relief." *Ziegler v. IBP Hog Mkt., Inc.*, 249 F.3d 509, 512 (6th Cir. 2001).

The central issues, and the ones on which this court rests its conclusion, are (1) whether plaintiffs' claim is one for a tax refund, and, if so, (2) whether plaintiffs' state law claims are preempted by federal tax law. "We start our preemption analysis by noting

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[5] Plaintiffs do not plead a breach of fiduciary duty but a breach of contract.

the existence of a 'presumption that Congress does not intend to supplant state law.' Without a 'clear and manifest purpose' expressed by Congress, pre-emption is inappropriate." *Wellons v. Northwest Airlines, Inc.*, 165 F.3d 493, 494 (6th Cir. 1999) (quoting *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654, 655 (1995). The second step of the analysis was set forth by the Supreme Court in *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996):

> Second, our analysis of the scope of the statute's pre-emption is guided by our oft-repeated comment . . . that "[t]he purpose of Congress is the ultimate touchstone" in every pre-emption case. As a result, any understanding of the scope of a pre-emption statute must rest primarily on "a fair understanding of *congressional purpose*." Congress' intent, of course, primarily is discerned from the language of the pre-emption statute and the "statutory framework" surrounding it. Also relevant, however, is the "structure and purpose of the statute as a whole," as revealed not only in the text, but through the reviewing court's reasoned understanding of the way in which Congress intended the statute and its surrounding regulatory scheme to affect business, consumers, and the law.

(Citations omitted).

We begin by reviewing the tax law implicated in this case. Defendant was required by 26 U.S.C. § 6042(a)(1) to file an information return with the IRS reporting payments of dividends[6] aggregating $10 or more made to any "other person" during any calendar year.[7] A corporation which furnishes an information return is required to give notice to the person who is the subject of the return by written statement (26 U.S.C. § 6042(c)) and is subject to a penalty, under certain conditions, for failure to comply with § 6042(a). With respect to dividend income, the Secretary may instruct a corporation to deduct and withhold a specified amount of tax if the payee underreports or there is a payee certification failure.

Plaintiffs' claims arise directly out of the information returns submitted to the Secretary by Centerior. Plaintiffs allege that Centerior did not report their

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[6] "Dividend" is defined as "any distribution by a corporation which is a dividend (as defined in section 316). . . ." 26 U.S.C. § 6042(b)(1)(A). Section 316 generally refers to a "dividend" as a distribution made out of earnings and profits. As the parties state, a non-dividend distribution is referred to as a "return of capital" and taxed under circumstances different from a "dividend."

[7] Section 6042(b)(3) states: "If the person making any payment described in subsection (a)(1)(A) . . . is unable to determine the portion of such payment which is a dividend or is paid with respect to a dividend, he shall, for purposes of subsection (a)(1), treat the entire amount of such payment as a dividend or as an amount paid with respect to a dividend." Although the court was unable to find caselaw interpreting this provision, the section suggests that the IRS anticipated having to resolve issues similar to those raised here: what portion of a distribution should be properly classified as a "dividend."

earnings and profits properly and hence caused plaintiffs to pay increased taxes on distributions characterized as dividend rather than non-dividend income. Most significant, plaintiffs articulate their damages as the amount of tax wrongfully paid on non-dividend income, i.e. on return of capital.

In clear and unambiguous language 26 U.S.C. § 7422(a) states:

> **No suit prior to filing claim for refund.**–No suit or proceeding shall be maintained in any court for the recovery of *any internal revenue tax alleged to have been erroneously or illegally assessed or collected*, or of any penalty claimed to have been collected without authority, *or of any sum alleged to have been excessive or in any manner wrongfully collected*, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

(Italics added). Plaintiffs complain of tax erroneously or illegally collected or, alternatively, of a "sum alleged to have been excessive." Their claims fall directly within § 7422 and require them to have sought a refund or credit from the Secretary before proceeding in this court.[8]

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[8] Plaintiffs admit that the statute of limitations bars their fil-

Defendant relies on *Brennan v. Southwest Airlines Co.*, 134 F.3d 1405 (9th Cir. 1998), and its progeny to support its argument. Plaintiffs in that case filed an action against various airlines, asserting that the airlines required passengers to pay an excise tax on domestic air transportation commenced prior to 1996. The airlines collected the tax from customers and remitted the taxes twice monthly to the IRS. The law pursuant to which the taxes were collected did not extend into 1996 yet airlines which sold tickets in 1995 for air travel in 1996 added the excise tax to the ticket cost. The airlines continued to collect the tax even though it was not renewed until August 1996, thus overcharging thousands of passengers. Defendants remitted most of the money to the IRS, refunded some of it to passengers and established an escrow account into which some money was deposited. The defendants did not keep any of the money.

The action was filed in state court and removed to federal court by defendants. The court overruled plaintiffs' motion to remand and subsequently granted defendants' motion for judgment on the pleadings. Plaintiffs appealed. Applying the artful pleading doctrine, the Ninth Circuit affirmed the denial of the motion to remand because "the IRC provides the exclusive remedy in tax refund suits . . .", *id.* at 1409, and thus preempts state law claims against a private entity. The court stated, "The question is not whether the airlines collected an internal

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ing of such claim with the Secretary 17 years after the alleged injury occurred.

revenue tax. The question is whether Plaintiffs have filed a tax refund suit within the meaning of the statute that governs tax refund suits." *Id.* Relying on § 7422(a), the court found that the statute's unambiguous language "doomed" plaintiffs' argument because even if the airlines did not collect an "internal revenue tax," the airlines collected a "sum."

The court articulated important policy reasons for its conclusion that plaintiffs sought a tax refund. First, it explained that a claim based on collection of an unauthorized tax could not be used to avoid § 7422 because "almost *every* citizen who seeks a tax refund alleges that the tax was collected without authority." *Id.* at 1410. Second, defendants were required to collect the tax; they did not choose that role. Accepting plaintiffs' theory would put the defendants in the position of collecting taxes at their peril and would allow claims to proceed, and perhaps succeed, against such defendants without giving them a way of being reimbursed by the entity which ended up with the taxpayer's money. Moreover, if the action proceeded in state court, the federal government would not be bound by a judgment against defendants.

The court's third point is especially applicable here. Section 7422 "afford[s] the Internal Revenue Service an opportunity to investigate tax claims and resolve them without the time and expense of litigation." *Id.* at 1411, quoting *DuPont Glore Forgan Inc. v. AT&T Co.*, 428 F. Supp. 1297, 1306 (S.D.N.Y. 1977). Finally the court pointed to the strict limitations period on tax claims. If a defendant has not filed a claim against the government in a timely

manner, a plaintiff could collect from the defendant and the defendant would have no way to obtain a refund. Such, of course, would be the situation here where the suit was filed 17 years after the alleged violation occurred.

Having concluded that plaintiffs' suit was one for a tax refund and having articulated the sound public policy for requiring a taxpayer to pursue his or her claim through the procedures specified in § 7422, the court easily found plaintiffs' claims were preempted.

Plaintiffs here counter that the airline excise tax cases are not applicable to these facts and rely instead on *In Re Air Transp. Excise Tax Litig.*, 37 F. Supp. 3d 1133 (D. Minn. 1999). In that case plaintiffs who shipped packages via FedEx during a specified period of time were charged an excise tax which was not in effect (the same issue raised in the *Brennan* case). Plaintiffs' claimed that their contracts with FedEx included the excise tax and that by having collected that tax, FedEx enjoyed a windfall. Plaintiffs argued, among other things, that by collecting the unauthorized tax, FedEx effectively raised its rate in violation of its contract. Defendant, relying on the *Brennan* line of cases, took the position that plaintiffs' claims were preempted by § 7422 because they were, in effect, seeking a tax refund.

The court distinguished the *Brennan* cases in two ways. First it noted that "the passenger airline courts all relied on the fact that the airlines had turned over the erroneously collected funds to the IRS." *Id.* at 1136. In contrast, FedEx did not pay any funds to the

IRS. Second, FedEx did not separate the shipping charge from the excise tax so plaintiffs could not determine the amount of refund to which they were entitled. The court limited § 7422 to those cases

> in which a taxpayer–one subject to an internal revenue tax–seeks to recover a purported and paid "tax" that was actually "assessed" or "collected" on behalf of the government *and that was actually paid to the government.* The use of the term "recover" in the statute carries the implicit assumption that the funds are, in fact, "recoverable"–that is, that the funds are either already in government coffers or, at least, are within the government's easy reach. The statute does not preclude actions where, as here, a person who was not subject to an internal revenue tax seeks to recover an amount alleged to have been collected by someone else, in breach of a contract between them or by some other unlawful means, where the collector never remitted that amount to the government.

Id. at 1137.

Here defendant never held any of the claimed overpayments; plaintiffs made their payments directly to the IRS. This distinguishes the *FedEx* case from the instant one and points out that given the lapse of time, if plaintiffs were to prevail against defendant, defendant would have no recourse against

the IRS. In other words, defendant alone would be responsible for payment of plaintiffs' tax refund.

Plaintiffs make much of the fact that the legislative history of § 7422 focuses on relieving agents of the government, public or private, of litigation against them for wrongful collection of taxes and does not suggest that the legislation should be extended to situations like the instant one. As defendant points out, however, they were required by law to report distributions and in some instances were authorized to make deductions from distributions. The IRC defines "dividend" and determines the tax on dividend and non-dividend income. The administrative process is in place specifically to determine whether the assessed taxes are correct. There is no question that plaintiffs could have raised this issue with the IRS, could have filed for a refund and could have pursued administrative remedies. The efforts to pursue a tax refund from defendants appears to this court to be simply an end run around § 7422 to avoid the statute of limitations defense.

To allow this suit to proceed would open the federal courts to every complaint by every shareholder for misstatement of earning and profits, every employee for overstatement of earnings on his or her W2 by an employer and every action by an independent contractor against a payor on an overstated 1099 under some theory of implied or express contract or fraudulent misrepresentation. The IRC was enacted to avoid such actions and to permit an injured taxpayer to proceed directly against the government for a refund.

III.

For the reasons stated above, the magistrate judge recommends that defendant's motion for judgment on the pleadings be granted.[9] All proceedings are stayed in this and the related cases pending Judge Nugent's ruling on the Report and Recommendation.

Dated: June 2, 2003

s:\Patricia A. Hemann

Patricia A. Hemann

United States Magistrate Judge

OBJECTIONS

Any objections to this Report and Recommendation must be filed with the Clerk of Courts within ten (10) days of receipt of this notice. Failure to file objections within the specified time waives the right to appeal the District Court's order. *See United States v. Walters*, 638 F.2d 947 (6th Cir. 1981). *See also Thomas v. Arn*, 474 U.S. 140 (1985), *reh'g denied*, 474 U.S. 1111 (1986).

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[9] Defendants in the consolidated cases have not filed such a motion. The court assumes that unless there are distinguishing facts, it would recommend that such motions be granted.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

JEROME R. MIKULSKI; ELZETTA C. MIKULSKI,
On Behalf of Themselves
and All Others Similarly Situated,

Plaintiffs-Appellants,

v.

CENTERIOR ENERGY CORPORATION;
FIRST ENERGY CORPORATION;
CLEVELAND ELECTRIC ILLUMINATING COMPANY;
THE TOLEDO EDISON COMPANY,

Defendants-Appellees.

No. 03-4486

Appeal from the United States District Court
for the Northern District of Ohio at Cleveland.

Nos. 02-02440; 03-00191; 03-00192; 03-07043

Donald C. Nugent, District Judge.

Filed: April 26, 2006

Before: BOGGS, Chief Judge; MARTIN, BATCHELDER, DAUGHTREY, MOORE, COLE, CLAY, GILMAN, GIBBONS, ROGERS, SUTTON, COOK, McKEAGUE, and GRIFFIN, Circuit Judges.

ORDER

A majority of the Judges of this Court in regular active service have voted for rehearing of this case en banc. Sixth Circuit Rule 35(a) provides as follows:

> "The effect of the granting of a hearing en banc shall be to vacate the previous opinion and judgment of this court, to stay the mandate and to restore the case on the docket sheet as a pending appeal."

Accordingly it is ORDERED that the previous decision and judgment of this court are vacated, the mandate is stayed, and this case is restored to the docket as a pending appeal.

The Clerk will direct the parties to file supplemental briefs and will schedule this case for oral argument as directed by the Court.

APPENDIX F

Statutory Provisions

28 U.S.C. § 1331.

Federal question jurisdiction

The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.

26 U.S.C. § 312.

Effect on earnings and profits.

(n) Adjustments to earnings and profits to more accurately reflect economic gain and loss. For purposes of computing the earnings and profits of a corporation, the following adjustments shall be made:

(1) Construction period carrying charges.

(A) In general. In the case of any amount paid or incurred for construction period carrying charges--

(i) no deduction shall be allowed with respect to such amount, and

(ii) the basis of the property with respect to which such charges are allocable shall be increased by such amount.

(B) Construction period carrying charges defined. For purposes of this paragraph, the term "construc-

tion period carrying charges" means all--

(i) interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry property,

(ii) property taxes, and

(iii) similar carrying charges,

to the extent such interest, taxes, or charges are attributable to the construction period for such property and would be allowable as a deduction in determining taxable income under this chapter for the taxable year in which paid or incurred.

(C) Construction period. The term "construction period" has the meaning given the term production period under section 263A(f)(4)(B).

26 U.S.C. § 7422.

Civil actions for refund.

(a) No suit prior to filing claim for refund. No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

(b) Protest or duress. Such suit or proceeding may

be maintained whether or not such tax, penalty, or sum has been paid under protest or duress.

(c) Suits against collection officer a bar. A suit against any officer or employee of the United States (or former officer or employee) or his personal representative for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected shall be treated as if the United States had been a party to such suit in applying the doctrine of res judicata in all suits in respect of any internal revenue tax, and in all proceedings in the Tax Court and on review of decisions of the Tax Court.

(d) Credit treated as payment. The credit of an overpayment of any tax in satisfaction of any tax liability shall, for the purpose of any suit for refund of such tax liability so satisfied, be deemed to be a payment in respect of such tax liability at the time such credit is allowed.

(e) Stay of proceedings. If the Secretary prior to the hearing of a suit brought by a taxpayer in a district court or the United States Claims Court for the recovery of any income tax, estate tax, gift tax, or tax imposed by chapter 41, 42, 43, or 44 (or any penalty relating to such taxes) mails to the taxpayer a notice that a deficiency has been determined in respect of the tax which is the subject matter of taxpayer's suit,

the proceedings in taxpayer's suit shall be stayed during the period of time in which the taxpayer may file a petition with the Tax Court for a redetermination of the asserted deficiency, and for 60 days thereafter. If the taxpayer files a petition with the Tax Court, the district court or the United States Claims Court, as the case may be, shall lose jurisdiction of taxpayer's suit to whatever extent jurisdiction is acquired by the Tax Court of the subject matter of taxpayer's suit for refund. If the taxpayer does not file a petition with the Tax Court for a redetermination of the asserted deficiency, the United States may counterclaim in the taxpayer's suit, or intervene in the event of a suit as described in subsection (c) (relating to suits against officers or employees of the United States), within the period of the stay of proceedings notwithstanding that the time for such pleading may have otherwise expired. The taxpayer shall have the burden of proof with respect to the issues raised by such counterclaim or intervention of the United States except as to the issue of whether the taxpayer has been guilty of fraud with intent to evade tax. This subsection shall not apply to a suit by a taxpayer which, prior to the date of enactment of this title, is commenced, instituted, or pending in a district court or the United States Claims Court for the recovery of any income tax, estate tax, or gift tax (or any penalty relating to such taxes).

(f) Limitation on right of action for refund.

(1) General rule. A suit or proceeding referred to in

subsection (a) may be maintained only against the United States and not against any officer or employee of the United States (or former officer or employee) or his personal representative. Such suit or proceeding may be maintained against the United States notwithstanding the provisions of section 2502 of title 28 of the United States Code (relating to aliens' privilege to sue) and notwithstanding the provisions of section 1502 of such title 28 (relating to certain treaty cases).

(2) Misjoinder and change of venue. If a suit or proceeding brought in a United States district court against an officer or employee of the United States (or former officer or employee) or his personal representative is improperly brought solely by virtue of paragraph (1), the court shall order, upon such terms as are just, that the pleadings be amended to substitute the United States as a party for such officer or employee as of the time such action commenced, upon proper service of process on the United States. Such suit or proceeding shall upon request by the United States be transferred to the district or division where it should have been brought if such action initially had been brought against the United States.